# THE COMMON SENSE OF ECONOMIC SCIENCE

BY

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# PREFATORY NOTE

A FEW words may, by way of preface, be said on the aim of this book and on its method. The aim is to set out the leading truths and principles of Economics in a form that makes them easy to grasp ; the method is, by way of proof or illustration, to appeal, as far as necessary, alike to science and to history. It has, in not a few treatises on Economics, been the practice to lay down abstract propositions and definitions and then to go on, if not to prove, at least to argue in support of them. The practice renders the study difficult. Definitions there must be, but terms should first be explained and understood. Unfortunately, again, arguments relied upon have been too often merely quantitative. The element of quality which alike in the production, exchange and distribution of Wealth influences the dealings and ideas of men at least as much as quantity, has too frequently been overlooked. In some aspects of Economics it is very important, and merely quantitative arguments are, at best, no more than half-truths. It is for these reasons mainly that Economics has earned the name of the "dismal science."

But Economics, when the phenomenon of human society, and the natural laws governing its welfare, are

understood is the very reverse of dismal. No study is, on the contrary, more fascinating. This book is not and does not profess to be more than an outline, but I have thought it advisable to sketch the true workings of the world's monetary and financial system, since there have been few expositions of it in an elementary form. The outline shows the intimate links between that system and common welfare. When he has read this book, the reader, I hope and believe, will not only be interested in Economic inquiry, but will be able to pursue it further with critical intelligence.

E. D.

*London, May*, 30, 1922.

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# CHAPTER I

## FIRST PRINCIPLES

The World Naturally a Wilderness—Cattle and Food Plant Improvements—Origin and Economical Effect of Agriculture—True Theory of the Struggle for Existence—Man's Creative Ability—The Human, or Rational Type of Life has an Immensely Widened Power of Adaptation—The Human Struggle for Existence on a Plane by Itself—Division of Labour—Its Influence on Production—Division of Labour and Co-operation Complementary—Increasing Value of Mind in Civilised Life—Human Wants not Fixed or Limitable—Three Leading Aspects of Economic Truth—Society an Organism—The Natural Law of Society—Origin and Growth of Right and Common Security—Society Multiplies Means of Subsistence—Origin of the Arts—The True Social Law the Key to Economic Problems—Relationship of Economics to Politics and Ethics—The Economic System not an Invention of Men—Why Economic Laws are Beyond Human Caprice—The Opening of a New Era—Rival and Alternative Economic Systems Imaginary.

VERY simple, yet very important, the first principles of Economics, clearly understood and correctly stated, will be found the key to many apparent enigmas. It has been common to start off with an abstract definition as, for example, that Economics is the science of the production, exchange,

and distribution of wealth. The better procedure, however, is to set out from facts.

Our first fact is that in a state of nature the earth is a wilderness. Land, in the natural state undrained, is, where not barren, covered with wild growth. Neither cattle nor the common food plants, as now known, are Nature's unaided products. They are the outcome of human skill and art. Nature, unaided, produces buffalo. As different are the wild wheat plant and the wild oat from the cultivated varieties. By art and by selection over a prolonged period of time the buffalo has become the shorthorn, the Hereford, and other breeds of stock; the wild wheat plant and the wild oat have been transformed into descendants yielding ten times the increase. The wild varieties produce up to 20 grains; the cultivated varieties will bear up to 200 grains.

How did these changes come about? In his struggle for existence Man has passed from hunting to pastoral pursuits, from pastoral pursuits to cultivation, from cultivation to manufacture; from manufacture to commerce. These changes have been slow. But we now know that civilisation is of vast antiquity.

Let us consider the changes a little more in detail. Hunting taught man the advantage of taming and preserving certain breeds of animals. His supplies of food and, where needed, of clothing, then became more assured. Flocks and herds became his primitive wealth. In turn need of pasture led him to see that, drained and cultivated, land could be made to yield more abundantly. So little by little agriculture came into being. Adaptation of land for pasture,

cultivation of land for human food, improvement in the breeds of cattle and flocks, went on side by side with the selection of plants.

In that connection take another fact. The nitrogen of the Earth's atmosphere, by slow but constant chemical action, penetrates the soil, and aided by the action of water, unites with the carbon constituents of the soil to produce the food of plants. What then happens when the soil is loosened and turned by the spade or the plough? The process of fertilisation is speeded up, and there is done in one season what Nature, unassisted, would hardly do in a hundred seasons.

What has been the effect of all this? By agriculture at the present day land can be made to yield, acre for acre, up to 1,000 times the casual foodstuff gleanings of a wilderness.

**To increase thus the yield of land is, for productive purposes, exactly the same thing as multiplying its area. Economically that fact is very important.**

There is a theory which puts the human struggle for existence and the brute struggle for existence on the same plane. The theory is bad reasoning. To exist, the brute must destroy either plant life or other animal life for food. But Man ages ago rose from the merely destructive to the creative level. The distinction between the two is radical, and any and every system of alleged Economics which ignores the distinction is worthless.

The distinction is founded on the further fact that Man has not only a rational mind, but a body and

physical powers in conformity with it. He is, in short, **the rational type of life.**

It is a condition of the existence of life in the physical form that it must adapt itself to its environment. **The rational type of life has an enormously widened power of adaptation.** Human intelligence, skill, and art have brought about an increase of the means of subsistence that Nature alone could not encompass. Apart from intelligence and the gains of knowledge handed down neither cattle, nor the full resources of the soil, nor forests, nor minerals, nor the powers of water, heat and electricity could have been utilised. They would have been all there, but they would have all been going to waste.

As the physical wants of man are food and warmth, and as warmth means both clothing and shelter, so apart from intelligence, human life on this globe must have remained, as it once was, limited to a few favoured spots, and very limited even there.

But by turning the resources of Nature to account human life has been enabled to spread over the whole globe. And that process is still going on. So far are the resources of Nature from having been made use of to the full that the field for their further utilisation is even yet beyond computation. In every Age men have believed themselves at the end of the journey. They are not even in sight of the end.

**These then are among the first truths of Economics that human intelligence places the human struggle for existence on an entirely different plane from that of other forms of life and that the preservation, increase, and welfare of human life**

**are bounded only by the extent to which Man can make use of natural resources.**

We pass on to another aspect. Seeing that human sustenance is the result of human intelligence, how does Man's ability to produce grow? The reply is by sub-division of labour. If every man had, unhelped, to supply all his own wants, human life could never have risen above the lowest level of primitive penury, and the lives of all would have remained for ever confined to one poor, narrow, and uniform groove. The great advantage of rational mind lies clearly enough in communication with other rational minds. Because of this, division of labour was early seen at once to lighten labour, and to enlarge its results.

This is another process that is continuous. Not only is time and effort saved, but specialisation of crafts and callings is the secret of skill. Slow and elementary in primitive societies, it is for that reason quickened as civilisation rises, and is most elaborated in advanced societies. And so long as there is progress in civilisation it is not a process any resistance can arrest.

**Division and sub-division of labour consequently is characteristic of human life everywhere. There is no other way in which production can be improved.**

Science discloses that differentiation of function and co-operation between the organs of any living structure are complementary one of the other. Each implies the other. We also find that the higher the vital activity is the more complex the structure is, and that the more complex the structure is the more marked

is the specialisation of functions, and the more complete the interdependence between the parts.

Illustrated as these principles are in the life of man as an individual, they are not less illustrated economically in the life of human societies.

How illustrated? Division and sub-division of callings and crafts—specialisation of function—fosters variety of skill and talent. But from that very fact co-operation—which means interdependence—becomes of greater mutual advantage. Thus, together, sub-division and co-operation afford more and more openings for the resources and activities of mind.

It has been supposed that co-operation can be artificially imposed while sub-division is controlled and checked. The belief is a delusion.

Not only are these economic tendencies a saving of time and effort, and an incentive to skill; they bring out the further truth that, as civilisation rises, production and its rewards are determined much more by intelligence than by physical strength. Though marked, differences between men in point of physical strength are within very definite limits; differences in mind power and in knowledge may be very wide.

We have then as our second aspect of economic truth, the complementary relationship between division of labour and co-operation, and the effect of both in increasing production and giving play to the powers and talents of mind.

This second aspect, however, opens up a third, which is that the more production advances, and the more efficient it is, the fewer comparatively become those

engaged in satisfying primary necessities, and the more numerous those engaged in other than primary production.

In societies low in the scale of civilisation nine-tenths of the population are cultivators of the soil, and in a backward state of agriculture necessarily so. That was the case in England and in Europe generally even three hundred years ago. Productions of taste and elegance, using the terms in a broad sense, were then rare and costly. In modern Europe cultivators of the soil are not more than half the population, and productions of taste and elegance, in the same broad sense, have become common. More foodstuffs can be produced by fewer hands. Were it not for this falling proportion of those needed to supply primary wants, the growth of industry and the arts would not have been possible. Indeed, it is never possible anywhere save under such conditions. But in modern agriculture, with modern appliances, four men may grow wheat enough to feed 1,000 persons.

Production, however, though it has often been so dealt with in treatises on Economics, is not a question of quantity only. It is also a question of quality. Not only is measure of effort involved, but degree of skill. And quality means preference, and includes design and adaptability—a higher usefulness.

There has to be kept in mind, too, the further fact that **human wants, so far from being stereotyped and fixed, grow with the means of satisfying them.** In the matter of food they might, to begin with, have been shellfish swallowed raw. They now cover a vast range alike in production, variety, pre-

paration, nutriment and delicacy. In the matter of clothing they might once have been the undressed skins of animals. They now range over a wide choice of fabrics alike in materials, colours, patterns and costume designs. In the matter of shelter they began with a cave, or a tree dwelling; they now include habitations and their furnishings of every degree up to palaces. So with other needs and conveniences.

While nobody produces what nobody wishes to have, the fact remains that the luxuries of one Age may be the necessities of another. It is because human wants are not fixed and stereotyped that civilisation has advanced. Time was when white bread, shirts and bedsheets were luxuries. They are now found in every household.

We have then three leading aspects, so far, of economic truth.

**First, human intelligence occupies in the struggle for existence, and in adaptation to environment, a plane peculiar to itself—the plane of ability to create.**

**Secondly, intelligence, in turning to account the resources of nature, works by and through the complementary means of differentiation of crafts and callings, and co-operation.**

**Thirdly, with advancement of production, the ratio of those engaged in satisfying primary wants declines, and the ratio of those engaged in meeting higher wants increases, this change being also a reflection of the fact that wants grow and vary with the means of meeting them.**

From these three aspects of economic truth the inference is plain. Human society, the outcome of the human mind, is an organism not a mechanism. The economic system, which is world-wide, is the outcome of natural causes, and not merely a creation of human law. No man invented or designed it. Nor can its abiding tendencies be changed by human caprice. Every attempt of human ignorance or caprice to defy the working of economic tendencies always and inevitably fails.

Unfortunately, in much of the discussion on Economics, society has been dealt with as a supposed mechanism, and its activities as determinable and computable in terms of quantity only. Economics of that kind have little claim to the name of science.

But if society is an organism, it is certain that society has its natural law, and that that natural law of society is an important and integral part of Economics as a science.

What is the natural law of society?

As bearing upon human preservation and welfare society serves three purposes. First, it affords individual men common security. It relieves men personally of the need of self-defence by making defence a collective obligation. Applied to begin with to the security of life, this was by degrees extended to security of possessions. And it arose out of and was extended by the suppression one after another of gross forms of wrong. It is important to realise that every form of wrong thus put down means a co-related form of right set up. Such has been the evolution, very slow and marked by many ups and downs, of justice and law.

Inevitably suppression of gross wrongs in furtherance of common security leads to the recognition, shaping out, and enforcement of rights. First of all, the right of defence against wrong is admitted and allowed as a duty of the family or clan. Next, as under the Feudal System, there is association for defence on a property basis. Finally, as law is evolved, the duty becomes that of the community as a whole.

Nothing in human experience has been harder to achieve than the rule of right. In one way or another it is always being invaded, trenched upon, or broken down.

But although the progress of man in civilisation is through "trial and error," the recognition of justice and law has not only lifted man out of savagery, it has a direct and vital bearing on material welfare. No community can prosper unless and until the rule of right prevails over the rule of wrong, and the prosperity is in exact ratio with the prevalence. All the teaching of history goes to show that the laws and government men live under encourage and strengthen the motives of industry, ingenuity and foresight, if just, and discourage and weaken them if unjust. There cannot be advancement in industry, discovery, and the arts of life where common security does not exist.

Common security, then, is both the first purpose and the foundation of society, and where they despise or defy it men are everlastingly brought back into respect for justice through war, pestilence and famine.

But from the standpoint of material welfare, society,

because it makes possible the division of labour and co-operation which would be out of the question save in social life, as already said, enables a thousand human beings to live in sufficiency where barely one could support life in a state of savage isolation. And this is its second consequence and purpose. While justice and law impose restraints they are at the same time a great emancipation. The very fact, for example, that in a modern settled state of society men do not fear to be individually and commonly attacked and robbed, enables them to go about their business with freedom. On consideration the relationship between release from fear and material welfare is as clear as noonday.

**In adapting himself to his environment social life has always for Man been the line of least resistance, and he could not possibly have made use of the resources of Nature apart from the phenomenon of organic communities.**

There is therefore yet another aspect of the natural law. Increasingly as material welfare rises, and merely primitive wants are more readily met, the innate tendency of Man is to develop new wants. But these are less and less wants of the body, and more and more wants of the mind. So springs up the magic circle of the arts. Material welfare has thus in turn a vital bearing on manners and on intellectual advancement. Tastes and pleasures, to begin with coarse and low, are by continued material welfare slowly but steadily refined.

It may consequently be said, for it is the truth, that common security with its recognition of justice and

right, material welfare with its influence on means and wants, and moral advancement with its effects upon manners, form, when taken together, a chain of causes and consequences. And the cause and consequences, because a chain, are reciprocal and cyclic. For example, if, as history proves, there be conversely a decline of manners, it will inevitably sooner or later be reflected in laws and government, and that reflection, weakening common security, will in turn as inevitably be shown in a decline of material well-being and a fall in the standard of welfare. Few nations, like few individuals, have been found equal to the searching test of prosperity and riches.

Viewed at short range, society seems an immensely complicated puzzle, and history a succession of accidental events. But viewed with detachment and at long range, the grand outlines of the social law detach and disclose themselves. **That law is the true key to every economic problem.** It not only throws a new and illuminating light upon history, it enables us to give the science of Economics a correct perspective. We are enabled to see that as concerned with material welfare and its increase and decrease, Economics is, through the natural law of society, related to Politics and government on the one hand, and to Ethics on the other. To expound Economics clearly without bearing these relationships in mind is out of the question. It gives a false view altogether to discuss Economics as though the one and only concern of society were the acquisition or loss of merely material wealth. The "Economic man" is a fiction because man is not economic only but political and ethical.

One angle of the triangle is not the whole figure. Many points in Economics cannot be rightly reasoned out without reference to Politics. On material welfare the laws of property and inheritance, the laws of contract and taxation have a most intimate bearing. Yet while for that reason within the scope of Economics, they are essentially political. Usages, customs and manners also have a direct bearing on material welfare. Yet they are properly ethical.

It is because, as said, society is natural and organic that economic laws and tendencies are beyond human caprice. We may rejoice that it is so, for human caprice would speedily reduce the world to a chaos. The economic system of the modern world is a vast whole into which men find themselves born. In part, the system is a very ancient social inheritance, but also in part the system is comparatively a new structure. Within the last hundred years more especially the differences made in space and time by steamships, railways, and telegraphs have linked up and multiplied the relations between communities in every part of the world, and that linking up has had on production and exchange an effect that truly has opened a new era.

Finally, it may be asked, putting the point in a nutshell, on what pivot the economic system turns. The pivot is free contract and the reliable enforcement of free contract. Slowly as civilisation has advanced, custom and usage, more or less rigid, has given place to free contract, and slowly the reliable enforcement of free contract has become a duty of public law. Where free contract and its enforcement are recognised

there is welfare; where free contract and its enforcement are abolished, there is penury. There cannot be rival and alternative economic systems. There is only one; and differences are merely differences in its development.

## CHAPTER II

# WEALTH AND THE CREATION OF WEALTH

Wealth the Means of Weal—Production and Consumption Spring from the Same Motives and Causes—Physical and Mental Wants—The Tree of Industry—Interrelationship of the Great Trades—The Structure of Industry Organic—Natural Causes Simple but Efficient—Division and Sub-division of Industries—Variations Due to Differences of Natural Resources and Climate—Origin of Commerce—Its Future—Wealth Potential and Actual—Ratio between Potential and Actual Wealth—No Practicable Limit to Potential Wealth—Welfare Depends on the Rate at which Potential Wealth becomes Actual—Saving and Intensification of Human Physical Effort—The Human Mind the True Fountain of Riches—Definition of Wealth.

WEALTH is the means of weal. There is weal when wants are satisfied. There is a state of weal, or wealthiness, when they can be satisfied. A person then is wealthy when he, or she, has or commands the power to satisfy wants—the wants of the body and the wants of the mind.

All human industry is directed to the production of wealth or the means of weal in some form. Production and consumption spring from the same motives and the same causes.

Human wants, as already said, are both physical and mental, Being what he is, Man does not live—and never if he can help it will be content to live—by bread alone.

Nevertheless physical wants come first, for though their satisfaction is much more limited than that of mental wants, which truly have no assignable bounds, they are of primary importance in Economics. As a science Economics considers the material welfare of men both individually and in the mass. In the mass physical wants as yet remain everywhere the main needs of by far the greater number, and as yet not even the primary physical needs of a considerable part of the human race are fully met. Over the larger part of the world society and civilisation have not risen so far to the common physical sufficiency level. When they have—and in course of time they certainly will—then mental needs, tastes, and desires open up an endless vista.

Since physical wants come first, the great main branches of the tree of industry are those concerned with the supply of food, clothing, warmth and shelter. The main branch of industry concerned with the supply of food and clothing is agriculture, arable and pastoral. Agriculture is indeed the trunk of the tree.

As soon, however, as we turn our attention to agriculture, we find that it not only by cultivation intensifies the natural production of foodstuffs and material for clothing ; we find that it cannot be carried on efficiently without implements, nor in these days without machines, which are no more than elaborated

implements. Unaided, the physical powers of man would for the purpose be well-nigh useless. But the manufacture of implements and machinery brings in engineering, and engineering brings in a whole world of invention and discovery. In turn engineering is dependent for its materials on mining.

That is a series of links on one side. On the other side we have the milling, preparation, packing, and transport of the foodstuff and other produce; the manufacture through all stages of the cotton, wool, jute, silk and leather used for clothing and furniture. Thus on both sides of the main trunk, agriculture, are great industries linked up with it. The interdependence is mutual; the benefits of supply, and the benefits of consumption, mutual. There is not only vegetable but animal produce serving the same double purpose of food and clothing.

In regard again to housing and the provision of warmth and light, furniture and appointments of dwellings, another great interlinked mass of industries is presented.

The point always to be kept in mind is that, whether connected with agriculture directly or indirectly, **the mass of industries is not an accidental or haphazard growth. It has been shaped first by human wants, and next by the advantages of mutuality in their supply, and it presents as truly organic a structure as society itself.**

Agriculture has relations with engineering, mining, and chemistry, and could not get along without them. In turn it depends upon milling and brewing, and the textile and leather trades. But all these are as much

dependent as agriculture on the engineer, the miner, and the chemist. Every industry, in short, has its part in the scheme. Every one is linked up with many others. The idea that industry is a chaos is pure delusion. Though industry has grown up from quite simple causes, those causes, while simple, are great currents of persistent tendency, and in the long run it is not possible to resist them. Simple as they are, they have brought forth all the marvels of human life. A simple cause has differentiated the element carbon into the almost infinitely varied plant and animal life of the globe. All natural causes indeed are simple, but they are marvellously efficient. The truth then is that industry forms not a puzzle, as often supposed, but a scheme. Admittedly its pattern may be crossed and confused; distorted by bad and short-sighted laws; or ravelled by violence. Nevertheless the abiding tendency is for the pattern to become clearer and more symmetrical, for the useless, superfluous and outworn to drop out, for the more useful, the more economical and the more desirable to grow up. There is as certain an evolution in industry as there is in species. The difficulty is that few see the pattern and design as a whole.

The main lines of the industrial plan are best understood by taking the great trades and considering the relations between them. The great basis and supply trades are agriculture, mining and chemistry; the great preparatory trades are milling, brewing, vintning, meat packing, and textile and leather manufacture; in the matter of shelter and warmth and light there are the timber, woodworking and brickmaking

trades ; slate and stone quarrying ; glass manufacture ; ironwork ; leadwork ; brasswork ; paper and paint manufacture ; gas manufacture ; electrical supply. Again there is the long list of industries concerned with the appointments and the furnishing of dwellings. Man finally is a tool-using creature, and engineering, like chemistry, is relied upon directly or indirectly by all.

The moment, however, we turn our attention to any one of the great trades in detail, we find it divided up into branches and these again sub-divided. There is not a general human want that does not give rise to a mass of industries. Leaving out of account the general wants of hunger and thirst, and protection whether against cold or excessive heat, we may take what seems by comparison a minor want, that among civilised peoples of cleanliness. Consider the industries which have arisen out of it ; the manufacture of soaps, starch, and borax ; the manufacture of pots, and pans, and of washing and wringing machines ; the manufacture of pipes, taps and baths ; the laying out of water-supply systems ; the manufacture of heating apparatus ; the preparations of oils, powders and perfumes ; the manufacture of brushes and combs. The list might be extended to almost any length.

Now this, though in very bare outline, presents us with a picture of the life of Man considered as a producer. Before going on to ask what the picture teaches, let us reflect on some of its variations.

Industry varies as between one country and another first of all with natural resources. While civilised man is compelled everywhere to till the ground,

because he could not exist in anything like the same numbers if he did not, neither soil nor climate is uniform. The soil and climate of one country may be better adapted to growing wheat; the soil and climate of another to growing vines, olives, figs, or cotton. Minerals exist in some places and not in others; some countries are rich in forests, others are open grassy plains; some have deposits of oil, others none. Industry therefore is bound to vary, and it varies much more than common human wants, even though these, too, are influenced by custom as well as by climate. When we come to deal with exchange it will be found that variation in natural resources, and differences in animal and vegetable life due to climate are one main cause of commerce. Meanwhile it may be noted that as the ability to exchange products as between one part of the world and another acts as a great stimulus to production, the tendency is for every civilised country to take more and more of what it wants of the products of the whole world, and to send its own products all over the world. As yet this tendency has been but very imperfectly developed. Its full development no doubt will, in the face of opposition and prejudice, take a long time. All the same it indicates the line of progress, and shows what wide room for progress there still is.

But we have also seen that industry and production vary according to knowledge, skill, and energy. These it is that work the miracles. **Wealth, being the means of weal, may be either potential or actual.** The means are actual wealth when they have been put into forms adapted to human welfare; they are

potential when they are waiting to be so adapted. In the form of fertility the wealth of the soil is potential; in the form of harvests it is actualised. Minerals in the earth are potential wealth; minerals dug out of the earth are actual wealth.

The wealth of any country therefore may be and usually is both actual and potential. It is actual, for example, so far as it has assumed the form of drained and improved land, roads, bridges, shipping, harbours, railways, rolling stock; vehicles of all kinds; buildings of all kinds; machinery, implements and tools of all kinds; furniture and works of art of all kinds; stocks in trade of all kinds; eatables and drinkables of all kinds; fabrics and clothing of all kinds. It is potential so far as it consists of land not yet cultivated, of forests, of minerals not yet turned to account, of oil-fields not yet opened up, of water-power not yet utilised, and generally of all the means of a weal that may be turned to account in the future.

Once more therefore there may be great differences between countries in regard to the ratio between actual wealth and potential wealth. Potential wealth is pretty evenly distributed over the earth's surface. On the other hand, the differences of actual wealth are very marked, and they are marked because they depend in part upon the character of the population, in part upon numbers. In old countries the proportion of actual wealth is higher; in new and thinly-peopled countries it is commonly, in relation to the actual wealth, small; even though the amount of actual wealth per head may be considerable. But there is no country in the world where all the potential wealth

has yet been turned into actual wealth, and over the greater area of the world potential wealth remains by far the larger proportion.

We have to be careful, however, not to run away with the idea that were potential wealth all turned into actual wealth, mankind would, as it were, have to shut down because the world would then be worked out. The time will no doubt come, though it is a long way off, when all the coalfields and oilfields of the globe will have been exhausted, but if the intelligence of man has not by that date found out how to make use of the inexhaustible and vastly cheaper substitute of electrical energy, the intelligence of man will be a failure. There is water-power and wind-power enough on the globe to do the work of all the coalfields and oilfields times over, and as the power of a lightning bolt has been computed to be equal to 50,000,000 volts of electrical energy, it is plain that such a source of power is without practicable limit. As to fertility, chemical science can now extract from the atmosphere nitrates enough to enrich the soil to any degree. The future holds many wonders.

Meanwhile **human welfare depends on the extent to which and the rate at which potential wealth becomes actual,** and this, as said, depends on knowledge, skill and energy. The proof is plain enough. Let a continent, however rich in natural resources, be inhabited by ignorant and savage people, and they will be both few and poor. Let it become inhabited by a civilised and instructed people, and, though a hundred times as numerous, they will be, beyond comparison, better off. The soil will be tilled; forests

and minerals made use of; rivers navigated and made to yield heat and light; roads and railroads will open up the wilderness; great and busy cities will spring up where there were only solitudes. In every form the civilised people will have wealth beyond the savages' utmost dreams. In the last 300 years we have actually seen all this take place.

It has been usual in books on Economics to say that wealth is the result of the three factors of Land, Labour and Capital, but that statement is hard to understand because it is an attempt to sum up in very abstract terms a great mass of complicated facts. Not only is wealth left an abstraction, but Land, meaning natural resources of all sorts, is left an abstraction, and Labour and Capital are left equally vague.

Economics, however, is a science which has to explain facts not merely static but dynamic. It is easy enough to understand what Wealth is without bothering to think of what Capital is, for Capital is only Wealth under a certain aspect, and it is a great error when speaking of Labour to give the impression that only manual or physical effort is implied. The merely manual or physical effort in human labour is nothing like so important a feature of it as the mental effort, and with every rise in civilisation becomes less important. **The whole course and history of the production of wealth has been an application, through discovery and invention, of aids which in results at once intensify human physical effort and save it.** Animals, implements, vehicles, machines, the powers of fire, water, air, and electricity have all been successively enlisted for the purpose. To suppose that

this application of aids to physical effort can be arrested is illusory. Were man suddenly to be condemned to depend upon his own muscle power alone, there is not a civilised society in the world that would not crash down into starving penury.

**What then is the true fountain of riches ? The mind of man.**

More and more human muscle effort is reduced in proportion to human brain effort. The work done by Man, as distinguished from the implements and machines he employs, is more and more work that demands intelligence, which after all is the outstanding human quality.

The production of wealth never has progressed, and never can progress in any other way but this.

Wealth then is the means of weal, and weal is the satisfaction of wants by the adaptation of natural resources to human welfare. **Wealth is anything and everything adapted or adaptable to meet human wants and desires.**

# CHAPTER III

## VALUE, AND THE PRODUCTION OF VALUE

Production of Wealth and Exchange of Wealth Inseparable—Means of Estimating Wealth—Definition of Value—Marx's Distinction between Use Value and Exchange Value—Exchange Value a General Estimation of Usefulness or Desirableness—Form of Wealth least Variable in Value Adopted as Measure—Use of the Precious Metals for Computing Exchange Values—The Production of Values in Industry—Values Created by Increase or Adaptation of Materials—All Work that Creates Values Productive—The Motive of Production.

ADMITTEDLY the description of wealth just given is not at all like the popular notion. The popular notion is that wealth is money. It is true that the term wealth includes money's worth, and "money, or money's worth" is the common definition. But the definition explains the by no means easy term Wealth by equally difficult term Money, and in spite of the teaching about money's worth, the popular notion that Wealth is first, last and all the time Money, persists.

It has been said that in production, exchange, and distribution the world is one great going concern. O necessity the three have grown up together, and are

inseparable. That is one of the leading facts of Economics. Apart from exchange by far the greater part of production would cease. To arrest exchange is to destroy co-operation. To destroy co-operation is at once to throw production back to its starting-point.

Owing to this inseparableness of the production of Wealth from the exchange of Wealth, it has been everywhere recognised that for the purpose of exchange there must be some means of estimating Wealth. The estimation has to be that of one kind of Wealth in the terms of another kind, as for instance the estimation of iron, or bricks or timber in the terms of corn. However arrived at, the estimate, when formed, is the value, or worth. **Value then is the estimate of what any particular example of Wealth is worth in the terms of some other kind of Wealth.**

A distinction has been drawn between use value and exchange value, and the German economist, Karl Marx, devoted a good part of his well-known book on "Capitalism" to elaborating and explaining the distinction. The distinction, however, cannot be said to be of any great practical moment. The actual use value of anything is very largely the possessor's concern. A man may make great use of a thing or little; he may make good use of it, or bad use.

As will be seen when we come to deal with exchange, value, or worth, whether use value or exchange value, inevitably varies with time, place and circumstances.

Broadly, of course, the use value of things does enter in an important sense into their exchange value,

but exchange value is and must be the working pivot because it is arrived at commonly on a general estimation of usefulness or desirableness, as marked off from a particular or individual estimation. This generalised estimation is the price, a term which, like value, simply means computed worth.

Seeing, however, that the computation of the worth of one kind of wealth in the terms of another kind when the worth of each kind is variable, was long ago found to be cumbrous and uncertain, all civilised peoples have come to measure the worth of Wealth in general in the terms of some one kind believed to be least variable. Even primitive peoples hit upon some symbol, such as the notched stick, which made barter easier. And pastoral peoples have adopted cattle as their standard, computing everything else in terms of cattle.

Value as understood among civilised peoples means a generalised estimation of worth in the terms of a precious metal. Believed to be invariable in their intrinsic value, hard or impossible to imitate, and nearly or quite imperishable, the precious metals have long and universally been used as the means of computing values for purposes of exchange. It has to be observed, however, that before money could come into general use measures alike of weight, length, and bulk must have been adopted. But those having been adopted, the reasoning may be set out in this form :—

$x$ measures of Commodity $a$ are worth $c$ pieces of precious metal
$y$ " " $b$ " $c$ " "
therefore $xa$ equal $by$ since both equal $c$.

This is a much easier and more certain mode of comparison and reckoning.

Historically money first came into use as pieces of metal of a given weight. Then these pieces were stamped as a guarantee alike of weight and of purity. And that is just what coins are at the present day.

More will be said about this when we come to deal with money and currency. It is touched upon here because it throws light on another aspect of the production of wealth.

If we think of any industrial process we readily perceive that at every stage worth or value is added to the material dealt with. The farmer sows so much seed, and on reaping so much more, the difference is what the work done has added to existing values. Every year the harvests of the world bring into existence a vast total of new values in foodstuffs and raw materials. But when, for example, wheat is milled into flour and offals, the latter are, weight for weight, worth more than the wheat. Again, the difference is an addition to values. In like manner when flour is made into loaves, the bread, weight for weight, is worth more than the flour. At every stage there is adaptation, and with every adaptation value is added. Raw cotton is not worth so much pound for pound on the field as it is after it has been cleaned and ginned; and pound for pound it is worth more at the mill than at the compress. It is worth more again when spun; yet more when woven into cloth; yet more when finished and bleached; yet more when printed; yet more when packed and moved from mill to warehouse; yet more when transported from the warehouse to

where it is finally on sale. All these successive additions represent the final value, because every one of these successive services has been at the buyer's disposal in the process of production, exchange and distribution. And every one of these services, as adaptations of the material, and adaptations to the want it supplies, are additions to value.

Once more we may take iron. Its first actual value is as ore. But ton for ton pig-iron is worth more than ore, the difference being the value added by smelting. Refined into steel the material, ton for ton, is worth more again ; worked up into implements, tools, cutlery, or machinery, it becomes worth a great deal more. The value difference between a ton of cutlery and a ton of pig-iron is very wide. As a fact we in like manner take any material we like, for example potter's clay, and consider the difference in value, weight for weight, with the final result as porcelain ; or silica, and consider the difference, weight for weight, with the final result as glassware.

**Continually every day and in thousands of forms, and in all parts of the world, values are being brought into existence by the increase or adaptation of materials, and worth is always being evolved.**

This view of value it will be seen is comprehensive, and it means that every kind of work which helps to evolve value is economically productive work. Transport, adding to value, is productive ; design, adding to value, is productive ; planning that assists to create value, is productive. The work done in the world that really is not productive is very small. The true

view is to look at the multiplication and adaptation of products, and to realise that that is how actual wealth comes into being.

Immediately the motive of each producer is to create worth, for exchange of the worth he has created, or helped to create, gives him in return worth in a form, money, which enables him the more readily to supply his own wants. The immediate motive is self-regarding, but it should be noted that it cannot function without contributing to the common welfare.

# CHAPTER IV

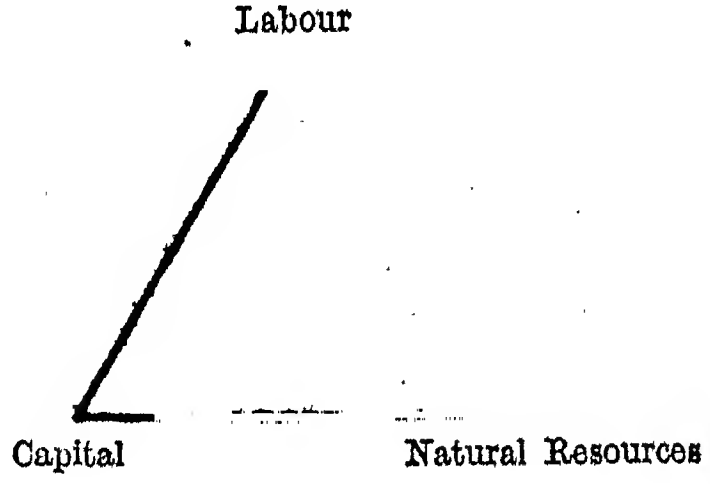
## LABOUR

The Elements of Production—The Inseparable Trio of Labour, Capital and Natural Resources—Labour's Two Constituents of Quantity and Quality—The Quality of Labour Improves its Production in Quantity—Labour Comprehensive and Complex—Improvement in Production Translates Labour from Unskilled to Skilled—Knowledge means Riches—Effects of Steam Power, Electricity and Machinery—The Surplus of Modern Civilisation—The Fear of Over-production—Why a Fallacy—Over-production Due to Difficulties or Defects of Exchange—Invention and Science have Humanised Labour—Rise of Labour in Quality and Skill only Possible through Saving Labour in Quantity—How New Openings for Skilled Labour are Made—Effects of the Division and Sub-division of Labour—Machine Processes and Thinking Processes—Real Value of Human Labour Lies in its Intelligence—Mental Work and Manual Work Inseparable—Productive Capacity of the World's Population.

HAVING formed an idea of what wealth is, and of what is meant by value or the measure of wealth, we can go on to consider the several factors which enter into production.

Of these Labour may be put first. It has, however, always to be kept in mind that just as in the life of the

world production is linked up with exchange and exchange with distribution, and that the three are inseparable, so the several factors or elements of production are similarly linked up. Graphically they may be represented as a triangle, thus :—




On the question of which of the three is the most important there has been endless dispute, and it may be added, endless prejudice, but if we are to get at the truth we have to judge of things without prejudice.

Now enough has been said already to show that Labour is supremely important. It is Labour which now keeps 999 out of every 1,000 human beings alive ; it is Labour which enables nine-tenths of the earth's surface to be inhabited. But for Labour natural resources would nearly all remain potential and unused. But for Labour Capital would not be wanted. Our triangle may be turned about in any way we fancy. Instead of Labour being put at the apex, Natural Resources may be put at the apex, or Capital. But it does not matter because it makes not the slightest difference to the facts.

**The moment we come to consider Labour we see that it has two constituents, quantity and**

**quality, and of these quality is at least equal to quantity or numbers.**

The effort of men in trying to improve their welfare has always been to increase the results of their work in proportion to the number who have to live upon it. Only in that way can the share of each become greater. But it happens, and this is a primary truth, that that cannot be done without at once influencing the quality of the work and the skill of the worker.

When, living by the chase, primitive man put his wits to work and invented the bow and arrow, his wits in due time showed him that if one man made bows and a second arrows, better bows and arrows could be made and more of them. Later, when out of the development of hunting men trained and kept cattle, labour was also divided up. Division of labour at once increased results and improved them. Yet again we come to the stage when the ground began to be tilled. With every improvement in the implements used more work was done with less effort.

The results were that not only as regarded foodstuffs, clothing and shelter fewer men could produce more, but that they could settle and live where they could not have settled and lived otherwise. In other words **the quality of human labour improves its production in quantity.** In results one man became worth half-a-dozen men.

To-day, after the lapse of ages, human labour over the greater part of the world has grown to be enormously elaborate and complex. But are the lines of advancement any different from what they were? Not a bit different. There is the same increase in the

results of work by the application to it of mind power, and the one difference is that the application of mind power is vastly more various and extended.

Let us consider this process a little further. Invention and discovery have been and are the means ; the motive is the desire the more readily to create value as giving greater power or ability to satisfy the wants and desires which widen with the possibility of being satisfied. Materially speaking, that is how men have risen from savagery to civilisation.

It is important to bear in mind that wants expand as production becomes the better able to meet them, because failure to perceive that very simple truth has led to one of the most serious of economic fallacies. **It is supposed that improvement in production merely saves and displaces labour. What it has done in fact, and does, is to translate labour from unskilled to skilled.** By abolishing merely human drudgery on the one hand, and on the other by lowering the cost and adding to the variety of productions, improvement creates new wants and desires which it requires as much labour as before to satisfy. Only the labour is intelligent instead of being unintelligent. As a merely physical machine Man is of no great account. In that respect he cannot compete with the horse, nor even with the ass ; but as a thinking machine his value is unique, and there is no definite limit to it.

Man, however, can neither invent nor discover unless he has and gathers knowledge. When therefore we get down to rock bottom we find that knowledge means riches and ignorance penury.

Now everywhere and in every age the men who have knowledge enough to be original and think for themselves are a minority, and often a very small minority. The majority have always been inclined to go on as they are, and to take the present state of things for the final state of things, and it cannot be said that the gratitude of mankind to inventors and discoverers has been overwhelming. Nevertheless, little by little, discovery as it accumulates forms the priceless social inheritance of the race.

For example, the mechanical advantages which mark the civilisation of modern Europe and America are applications of the mathematical science of the ancient Greeks, derived by them in part from the Egyptians and in part from the Chaldeans, and by the latter in part from Further Asia. When during the Dark Ages in Europe that science was for the time lost, the whole of Europe was wretchedly barbarous and poor. Re-discovery brought about the changes of modern times. The great modern additions to the inheritance have been the developed knowledge and applications of chemistry and electricity.

The effort to save labour in proportion to results which began when primitive man supplemented the muscles of his hands with the primitive hoe, has gone on ever since, and the enlistment of the power of animals and next of that of steam and of electricity is but a continuation of the process, for, as already said, machines are nothing more than elaborated implements and a more complicated kind of tools. The reason is that as the work done by a horse is ten times as cheap as the same work would be if done by men, so

work done by a steam-engine is thirty times as cheap. Further, as many steam engines and electric motors can be made as there is need for.

It has been pointed out that improvement in agriculture comes to the same thing as increasing the area of available land. In like manner increase in productive ability through invention and discovery is economically the same thing as increasing population, but at a very small fraction of the cost of maintaining that population. At the present time men have labouring for them and for their welfare in the form of machinery an additional physical effort equal in terms of human muscle work to that of twice the population of the globe. This means that in terms of merely human muscle work they have at command the effort of two additional world populations at one-fifteenth the cost of maintaining one. It is this vast surplus which has brought forth the effects of modern civilisation.

But it has often been doubted whether this change is, after all, entirely to the good; and whether, after all, it would be entirely to the good if instead of having the equivalent of twice the population of the globe working for them, men had the equivalent of ten times the globe's population, as there is no reason why in course of time they should not have and more likely than not will have.

A widespread fear has grown up of over-production, and it is not peculiar to any one class of society. There is a very extended desire in one way or another to limit production in the belief that it is a good thing to do less work for more money either as wages or as

profits. The belief is based on the idea that in that way something can be got for nothing.

Were everybody to act upon that belief the resultant decrease in the purchasing power of money would rapidly outstrip the increase in the nominal rise in profits and wages, and as the aggregate of wages and profits earned would steadily fall, the final consequence would be a double loss. Let us suppose that the world's production were, owing to the prevalence of this belief, to be halved; that only half the foodstuff were grown, half the minerals mined, half the timber cut, and sawn, half the amount of work done of every kind. The consequence would be scarcity, and as the costs of transport and of distribution would be inflated as well as the costs of production, the final price of commodities to consumers would not be double, but quadruple. The effect of this would be felt most severely by those with the smallest purchasing power. In the scramble they would be left to want. The fall in real wages and profits would always exceed the rise in nominal wages and profits. In other words, if the same nominal total of wages and profits could be got for half the product, the wages and profits would only have one-fourth of their former purchasing power, and actually in terms of goods and services instead of being raised, they would be cut down to one half.

The artificial scarcity argument is therefore a fallacy, and the fallacy becomes still more apparent if we assume that the world's production were thus to be reduced to one quarter. In that case commodities would rise to eight times at least their present cost,

and the same nominal wages and profits would in terms of goods and services be worth only one-eighth.

But in the next place when over-production is talked about, it is always tacitly assumed that present human wants are stereotyped and fixed. That again is an illusion. Over-production in any particular instance is due to defects and difficulties of exchange and distribution. Even present human wants are not fully supplied. While, however, it is nobody's particular business to propagate common-sense, would-be monopoly is always ready to pay for the diffusion of nonsense and error.

Not a little economic fallacy flourishes on the narrow and distorted meaning still commonly attached to the term "Labour." It is spoken and written of as though it meant nothing more than manual labour, and as though brain work formed no part of it, or was as merely incidental. The brain, in short, is thought of as the servant of the hand instead of the hand as the servant of the brain. Of course that topsy-turvy idea is simply foolish. Brain work is essentially and distinctly **human** work, and the more Labour becomes intelligent the more is it humanised. But how is Labour humanised and "de-donkeyfied" by the abolition of mere human drudgery? By one means only—the saving of human labour in quantity. The saving of human labour in quantity, which is always the effect of invention and science, does not mean the doing away with or the lessening of human labour. It means its translation more and more into work of intelligence and skill. **Had it not been for the**

**saving of human labour in quantity, its rise in quality and skill would have been impossible.**

As Labour in the true economical meaning of the term comprehends every effort whether of muscle or of brain that assists to create or where necessary to conserve value, its meaning is at once wide and various. It is in its less intelligent forms that human labour can by science and invention most readily be saved, and since its cost to result falls as its intelligence or quality rises, the economic impetus to abolition of human drudgery is constant. But what has been the result?

Apart from the saving of labour in quantity, thousands of products, now common, would not merely have remained costly and rare; the greater number of them would never have been heard of. The saving of labour in quantity, therefore, does more than reduce the cost of products; in a yet greater degree it promotes their use and consumption. This very saving then provides new openings for skill and design of every kind by bringing the products of skill and design within common reach. And that is what is meant when it is said that the process is one of translation into higher grades. Further, the successive discoveries of substitutes for mere human muscle work have given human labour richness and variety. They have opened out new branches of productive activity in every direction. More and more Man, as a producer, becomes too costly and too valuable to be used as a mere piece of physical mechanism. More and more his value as a worker lies in his intelligence.

Apart from saving in quantity, the level of quality and skill cannot rise.

This truth may be illustrated from any of the great industries. What would be the cost of implements, tools, cutlery and machines if the only source of power in manufacture were human muscle? What would be the cost of fabrics and clothing? What would be the cost of transport if men had to carry everything on their backs? A locomotive can pull a load of 1,000 tons, and transport therefore as much as 20,000 men. But it can transport such a load at twenty times the speed. The real result, therefore, is 20 × 20,000, or 400,000. **If products, now common, had for these reasons continued to be costly and rare, the mass of skilled and intelligent labour engaged in making them could never have come into existence.**

The two great industries in which it is least easy to economise labour in quantity are agriculture and mining. But even in agriculture, though the movement seems by comparison slow, there has been, as pointed out, a marked fall in the ratio of the population so employed, and yet an equally marked increase in foodstuff products. The change has arisen from improvements in implements and appliances; in methods of culture; in the breeds and qualities of stock, cereals, roots and fruits; in the drainage and manuring of land. And the change is still going on. The land of Europe does not yield one half of what it is known to be capable of yielding; the land of North America hardly a fourth. The change is not one from wealth to poverty; it is a change from poverty

to wealth. In coal mining, if coal had still to be wound up to the pit bank by human effort, coal would be so dear and its use so restricted, that nine-tenths at least of the hewers and other skilled men employed in the industry could not be employed. Both in mining and in agriculture electricity and chemistry must in time bring about yet further changes. The wonderful product coal yields nearly a hundred substances, every one of them much more valuable than the crude mineral. Will that change depress the lot of the miner? Quite the contrary.

Very intimately the saving of labour in quantity is related to the division and sub-division of labour. Division and sub-division mark off merely physical effort from effort involving mind and skill, and it is not practicable to employ machinery in production unless and until division of labour has so far progressed that machine processes are distinct from and subordinate to thinking processes. The common notion is to regard the man as subordinate to the machine, and to imagine that human labour falls in value as machinery becomes more elaborate and complete. The notion is all wrong. More than anything machinery has given human labour a vast range, for the term rightly includes the work of employers as well as of employed; the work of professional men as well as the work of artisans. **The more elaborate and delicate machinery is, the higher must be the skill and intelligence necessary to use it.** Labour is not degraded by it, and Labour ought not to be looked upon as so degraded, nor treated as degraded. This deadly error has done nothing save weaken

incentive in industry, and stir up ill-will. It has more than anything else led to repulsive conditions of employment.

Machinery, for example, is used in the making of boots because there are seventy different operations involved in turning out a boot. If, as formerly, one man did all, including the merely physical operations, the making of boots would be slow and boots would still be luxuries. By sub-division of labour and the use of machinery the manufacture has been immensely speeded up. But has this lessened the number of people who live by making boots? Not at all; there are times over as many. Why? Because the mass of the population no longer goes barefoot.

Labour then, as an element in production, is a term of wide range. The work of the engineer who plans is as much labour as that of the men who carry out the plans. The work of the architect is labour not less than that of the men who chisel the stone or set the bricks. The work of the merchant who seeks out products and finds markets for them is as much labour as that of the captains and crews who transport, and that of the dockers and warehousemen who handle his cargoes. And the work of his accountants and clerks is labour. **Emphatically the work of the world is effort not of body only, but much more effort of mind, and emphatically it is above all the work of the mind which has created civilised industry.**

Lay hold of the simple truth that mental effort and manual effort are inseparable, and it at once becomes apparent why every useful discovery and saving of labour in mere quantity opens out new wants, and new

demands. It was once thought that railways would merely ruin the stage-coaching and stage-wagon business, because it was never supposed that more people would want to travel or more goods would need to be forwarded. But with the growth of railways traffic both in passengers and goods expanded until to-day the world over it gives employment to millions. In like manner steamships by expanding ocean traffic have given a new employment to millions in dock and harbour work.

Since the beginning of the nineteenth century, owing to discovery, the average productive capacity of the world's population has doubled. But the changes brought about by discovery, though they have raised the level of welfare and broadened the openings for intelligence and skill, have been more rapid than the diffusion of knowledge. There are great masses of population whose productive capacity through lack of skill and training remains narrow, yet whose wants and desires, stimulated by the life around them, are not narrow. That discrepancy is one of the main causes of social discontent. It is illogical, however, to lay the blame on science and invention. The blame ought to be laid on ignorance, prejudice and neglect.

# CHAPTER V

## CAPITAL

Consumable Wealth, and Wealth in More or Less Lasting Forms—Margin over Primary and Immediate Needs—Money an Embodiment of Value in Convenient Form—Why Savable—Wealth Takes Other and More or Less Lasting Forms in Proportion as the Ability to Produce Consumables Exceeds their Consumption—The Borrowing and Lending of Money—Interest a Charge for Service Plus Risk—Wealth either Passive or Active—Active when Used to Produce More Wealth—Definition of Capital—Active and Passive Capital—Invested and Liquid Capital—The Relationship between these Forms—Ratio of Active Capital to Passive—Effects of Increasing or Decreasing the Ratio of Active Capital—Influence on the Quality and Variety of Production—The Function of Active Capital in Industry—Money More Potential as Civilisation Rises—Economically Labour is the Employer and Capital the Employed—Function of Banks and Bankers—Translation of Passive into Active Capital—Joint-Stock Investment—Its Economic and Social Importance—Conflicts of Capital and Labour a Misnomer.

IT is better not to attempt a definition of Capital to begin with, but as with Labour, to leave the definition until something like a clear idea of Capital has been formed. No problem in Economics has led

to so much dispute as the question of what Capital really is.

The review of production so far as it has gone in the foregoing pages, leaves it evident that by far the greater part of the produce of the world's labour year by year is consumed year by year. This is the case with all foodstuffs, and with nearly all the material produced for clothing. But everybody sees and knows that in civilised communities wealth takes many other and more or less lasting forms. We have here in the first place to inquire how that has come about.

Again let us glance at the matter historically. Even in primitive communities there are some of these more or less lasting forms of wealth—weapons of defence and of the chase; implements; rude furniture and so on. The difference between primitive and advanced communities in this respect is that wealth in more or less lasting forms is, with the former, little, both in amount and in variety; with the latter it is great, and beyond comparison more various, and it is always in progressive societies becoming yet more various.

Now it is manifest that before Man had the time or means to produce something he fancied in a more lasting form, he must so far have been able to satisfy the physical wants of hunger and protection against cold, as to leave him the opportunity so to employ himself. The production then of any such wealth argues a surplus or margin over the satisfaction of merely primary and immediate needs. Hence as the satisfaction of merely primary and immediate wants improved, wealth in more or less permanent forms grew, and the practice of barter grew at the same

time. So by slow evolution came about the use of money.

But the use of money, independently of its function as a medium of exchange, has had social consequences it is important to notice.

Money, being a symbol and measure of value, has this characteristic that the possessor of it, unless necessity dictates, can exchange it when he will and for what he desires. **As a symbol it remains the embodiment in convenient form of the goods or services given for it, and it can be changed at will back again into goods or services to the amount represented by the embodiment of value.** It can be changed at will, or alternatively it can be saved. Unlike most other forms of wealth, it is, in the form of a precious metal, imperishable, or practically imperishable. Hence a man having more than he himself could use of a perishable form of wealth like, say, corn, in exchanging the corn for the equivalent of its value in a precious metal, was no longer under any fear that his wealth would lessen by keeping it. So the desire both to obtain money and to save it is very widespread and very old.

A common trait of savage and primitive peoples is improvidence, and a trait of civilised peoples, and especially of the more advanced classes among them, is foresight. For this there is a reason. Among a primitive people a symbol of value can command little; among a civilised people money, as a symbol of value, can command, materially speaking, much. The incentive therefore to possess it is stronger. Also among civilised peoples and from these causes contrasts

of individual wealth and poverty are immensely more pronounced.

We have then at the outset the fact that **in proportion as the ability to produce consumables exceeds their consumption, the production of wealth tends to take other forms more or less lasting,** and we have the further fact that the use of money, the outcome of this tendency, has helped, by making exchange easier and more certain, to strengthen the tendency. That is one explanation of how in civilised societies wealth in more lasting forms has come to be as various as it is. But the fact again that money, being a title to wealth and a title in a comparatively imperishable form, could be saved, has had yet another social consequence—desire to borrow it, and willingness to lend it.

Placing it at the disposal of a borrower means placing at his disposal command of so much labour or service, or the results of labour or service in goods. That itself is clearly a service, since the lender foregoes possession in the meantime, and it may be added, takes the risk, unless there is security, of not seeing his money back. The charge for the service is **interest,** and the rate of interest includes not only payment for the service rendered, but a charge for the risk taken. The latter element is in effect a premium of insurance.

Now Wealth in more or less lasting forms may be adapted either for convenience or enjoyment, or for the production of more Wealth. It may be either passive or active.

As used for the production of more Wealth it may take the form of the improvement and drainage of

land, and much of the wealth of every civilised country so exists. Roads and bridges may be put in the same category since they are a complement of land improvement. Implements, tools, apparatus and machinery; buildings used for industrial and commercial purposes, whether works, mills, warehouses, storehouses, offices or shops; railways and the equipment of railways; quarries and mines; ships, harbours, docks and canals; waterworks and aqueducts, are all part of a country's more or less permanent wealth used for the production of more wealth. Less permanent are flocks and herds; horses and other live stock, and stocks in trade of consumable goods, but they are constantly being replaced.

Whether passive or active Wealth is estimated in terms of money. There is indeed no other convenient or practicable means of computing it.

The point to be kept in mind regarding Wealth in any more or less permanent form is that at some time or another it has had to be earned. It represents the surplus or margin of current production over current consumption.

The labour of hand and brain engaged in the production of more or less endurable Wealth has not only to be paid out of the past surplus, but has to share in the current supply of consumable things. It follows that there must be enough consumable things to cover the share. Were the whole labour of a community absorbed in providing for itself necessary food, clothing and shelter, its other wealth would be and would continue to be slender. But if food, clothing and shelter for all can be produced by, say, 60 per cent. of the work-

ing population of all classes, then the other 40 per cent. can be and will be engaged in producing other forms of Wealth, adding at once to the stock of more or less permanent Wealth and to its variety.

"Capital" is a term sometimes used as meaning Wealth in general; sometimes as meaning Money only; sometimes as signifying Wealth made use of to produce more Wealth. The latter is, however, properly speaking a country's active Capital. **Capital, active and passive, is Wealth in every form that has a presently existing monetary value.**

It should be noted that passive and active Capital alike may exist either in an invested form as Wealth, or in the liquid form of money as representing Wealth, and changeable into wealth. The relationship may be put thus :—

$$\left.\begin{matrix}\text{passive}\\ \text{active}\end{matrix}\right\}\text{———————}\left\{\begin{matrix}\text{invested}\\ \text{liquid.}\end{matrix}\right.$$

The value of a motor-car used for pleasure only is passive invested Capital; the value of a motor-car used for business purposes is active invested Capital; a private hoard of money is passive liquid Capital; a deposit of money in a bank earning interest is active liquid Capital.

There are two further characteristics of Wealth considered as Capital which it is of consequence to notice.

The first is the ratio of active Capital to passive. The ratio of course varies considerably. Some countries have only a low proportion of their Capital active; others have a high proportion.

We touch here upon one of the secrets of the

advancement of nations in material wealth and welfare. Steady addition to the ratio of active Capital has the same effect as, in the saving of money, the addition of interest to interest.

Let us suppose the total active Capital of a country to be £100,000,000. With an addition annually of 5 per cent. the active capital is doubled in about fourteen years, since the successive yearly additions are 5 per cent. on 100, 105, 110, 115, and so on. At the end of fourteen years the annual addition at 5 per cent. will have grown from £5,000,000 to £10,000,000, and the total of the annual increase is always rising. Consequently at the end of twenty-one years the active Capital will be trebled, and since the annual increment has then become £15,000,000, at the end of twenty-five years the active Capital will have quadrupled. In 100 years at a 5 per cent. rate of annual increase, it will be sixteen times as great, or £1,600,000,000.

There is nothing at all fanciful about this computation. It was exactly in that way that the active Capital alike of Great Britain and of the United States was built up during the nineteenth century.

**The effect of such an increase of active Capital not only on the volume of production, but upon its variety and quality is very pronounced.** Under such conditions variety will always be widening and quality rising. There is a constant addition to wealth in every more or less lasting form, passive as well as active. But also under such conditions the average rate of return upon an active Capital, its "wage" will tend to go down, and attracted by the better

return it will tend to seek employment abroad. Development of new countries, however, fosters commerce, and by better supplies of foodstuffs and raw materials helps the employment of more active Capital at home, while opening up new markets overseas for finished products. And the latter will be both more various and higher in quality for their cost, for these are advantages which a country with a high ratio of active Capital is in the best position to offer. Such a country, therefore, will not only have a large and varied production, but a wide and varied foreign trade.

If what has been said is true—and it is,—then the converse must be equally true. If active Capital be diminished from whatever cause and its ratio to passive Capital lowered, there will be all the contrary effects. Production will decline not in quantity only, but in quality and in variety, but in quality first of all. So far as production has become dependent on foreign markets this will be injurious. Further, there will be a constant diminution of wealth, passive as well as active, and many forms of wealth will one by one disappear as superfluous or over costly. In the decline of economic welfare civilisation is robbed of its bloom.

In speaking of Wealth the phrase has been used "in more or less permanent forms." With the exception of gold, which is imperishable, there is nothing esteemed Wealth, or the equivalent of Wealth that is permanent. All Wealth, passive or active, in one degree or another demands renewal, and neglect to renew or repair is not only a loss of Wealth in itself, but the loss goes on in a rising ratio as the neglect is prolonged. The wastage of wealth actively employed

in the production of more wealth is heavier generally than that of passive wealth. Renewal of it therefore and constant renewal is a necessity. This applies to all productive assets.

The function of active Capital in assisting production calls for a further though brief elucidation.

Money itself, while not Wealth of itself, is, as a title to Wealth in the hands of its possessor, the potentiality of Wealth, and it has been common to include this potentiality as Wealth for practical purposes.

It has been said, truly enough, that a man cannot eat money, nor drink it; neither will money, as money, clothe a naked man or shelter a houseless man, and if a man had a million pounds in gold coin where there was neither food to eat nor water to drink, the million would not be of the slighest use to him. But let us take the case of a people who having a productive surplus over their consumption turn the surplus into money, and keep it in the form of money. One case of that kind, though the surplus is narrow and variable, is India. From time immemorial the people of India have hoarded gold, and the hoard has in the course of centuries become so large that it is estimated to equal one-third of the world's total stock of the metal. To that extent the people of India hold a potentiality of wealth, which if turned into active Capital would add largely to production. It would, for example, create irrigation works and railways on a great scale. But beyond the satisfaction of possession they derive no benefit from it, and sacrifice between £30,000,000 and £40,000,000 a year in the shape of return.

Another case is that of France, but with the differ-

ence that the French people have been accustomed to lend their money and preferably to governments, believing loans to governments the most secure. Payment of returns upon these loans, where not repudiated, takes the form of exports of produce, though not necessarily to France. Such return the French people may lay out in any way they choose, and where they choose. Largely, however, the return has also been saved, and again the benefit has been chiefly the satisfaction of adding franc to franc. They could of course equally have turned it into either active or passive wealth. Money always has such a potentiality of translation.

We have then in civilised communities persons who on the one hand possess liquid Capital and on the other persons who need active Capital, and are prepared to employ and pay for employing the liquid as the active.

Money becomes more and more widely potential as civilisation rises. But none the less, its value to its possessor depends not a little on the possessor. It is worth most when backed by ability, skill, ingenuity, experience and energy, and as a fact a given sum of Capital may be a very different thing in the hands of one man from what it may be in the hands of another. And because in the hands of energetic and able men Capital in production becomes more dynamic, it is both worth the while of such men to borrow it, and worth the while of the less energetic to lend it.

In that connection we have another very serious economic misconception. Capital is nearly always spoken of as employing Labour. **But as a fact Labour in the full and proper sense of the word**

**is invariably the employer and Capital the employed.** Take the case where a man uses his own Capital. Does he employ it, or does it employ him? Obviously he employs it. And all Labour, even manual labour, is properly the employer of Capital. Labour provides the backing without which Capital would be useless. Capital is the servant. What it gives is a command over goods and services. Clearly, however, everything depends on the character of the command and the way the command is exercised.

The desirability of a link between enterprising men and saving men has brought into existence bankers and banking, and the banks are the institutions chiefly which have promoted the translation of passive liquid Capital into active Capital—into the buildings, machinery, shipping, stocks-in-trade, and all the rest of the apparatus of production and its assets. For Capital, when both active and liquid as it is when employed by bankers, takes on its most dynamic form.

It has required a great deal of time and the upgrowth of a very firm confidence to induce people to entrust their private hoards to bankers, but where such a usage most prevails over the habit of hoarding, the translation into active Capital is most rapid, and its ratio to passive Capital highest.

About the middle of the nineteenth century began a movement which as regards the provision of active Capital and its increase has been of momentous consequence.

That movement was the joint-stock investment of money. Before it began the floating of new enterprises was not easy, and the extension of existing

enterprises not so easy either. But joint-stock investment enabled the multitude of small savers to take shares in enterprises at home and abroad. As this both tapped and in part created a vast new reservoir of resources, for the savings of the not-rich many are far larger in the mass than the savings of the opulent few, the increase of active Capital went on at a rate never before known. This had the effects already outlined, and although joint-stock investment has been marked by fraud, its results on balance have been overwhelmingly beneficial. The economic and social importance of joint-stock investment has hardly as yet been fully appreciated.

The origin of joint-stock investment was desire to get over the inequality of the law of partnership, which, while it gave partners a joint and proportionate ownership of the assets, made them not only jointly but severally and individually liable for the whole of the debts and liabilities. In a joint-stock company the liability is limited to the ownership interest. It is apposite to note that a joint-stock investment is the purchase of a right to receive a given share of the net earnings of the enterprise; the purchase of a debenture the purchase of a share in an interest-bearing debt secured on the company's property. A vast amount of active Capital is now represented by these classes of securities.

A word may be added on the relationship between Capital and Labour. **The so-called conflicts of Capital and Labour are really nothing of the kind. They are conflicts of one form of Labour with another form of Labour.** Capital as Capital

does not enter into them except that on both sides the advantage of it is for the time nullified. Working men are strictly as much capitalists as employers. The character, skill and experience of a workman is as truly capital as are his employer's assets. They have a presently existing monetary value and in the aggregate a very large value. And that Capital is as much hit by suspension and dispute as the Capital on the other side.

The real function of active Capital in production is that of providing facility.

# CHAPTER VI

## NATURAL RESOURCES

The Most Important of Natural Resources the Fertility of the Earth's Soil—Improvement of Land the Basis of Industry—Rights to Land the Outcome of Repression of Wrongs—Rights Create the Initial Value of Land as Wealth—The Evolution of Tenure—Public and Private Ownership—Economic Effects—Improvement Value of Land—Situation Value of Land—Fertility Value—Mineral Value—Rent of Land—Rent of Land Analogous to Interest and Why—Building Rents—Site Rents—Royalties—Rent of Land and Surplus of Production—The Metayer System—Effects of Advance in Agriculture—And of Improvement in Transport—Land Ownership not an Economic Monopoly—The Theory of Henry George—The Social Desiderata—Advantages and Disadvantages of State Ownership—State Tenancy with Security of Tenure a Freehold—Situation Value under Free Contract—Nationalisation and Municipalisation.

NATURAL resources form the third element in production—the remaining angle of the triangle.

Of natural resources the most widely distributed and the most important is the fertility of the Earth's soil, the result of long ages of the chemical action still going on. As agriculture has improved it has had this result that while obtaining more from the soil it

exhausts the soil less, and the time does not now appear to be very distant when agriculture will have so far advanced that it will not exhaust the soil at all.

**The improvement of land by drainage and other means is now the broad basis of human industry.** As said, the surplus of productive power over the supply of primary needs is the foundation of Wealth in all other forms.

One of the most important, therefore, of social necessities is the encouragement of land improvement, and this is one of the points where Economics as a science impinges on Politics and Law, for emphatically the improvement of land turns upon common security. Common security needless to say has a dual aspect; security against external or foreign violence, and security against internal anarchy, injustice, and oppression.

The first does not concern us except in so far as nations, by cherishing feuds, and by turns invading each other's territory, destroy or retard cultivation and improvement. It has to be remembered that men have only very slowly and laboriously won the cultivated tracts of the globe from the wilderness, and wherever cultivation and improvement cease the wilderness is prompt to reclaim its own.

But security against internal anarchy, injustice and oppression is economically, as bearing on the basis of industry, of the first consequence. Security so far as land is concerned decidedly means in the first place security of occupation or possession. It is important to consider what that security is. As a fact it is the

outcome of the repression of a group of wrongs,—the wrongs of attack, forcible ejectment, damage, raiding, and trespass. These wrongs were checked first by private defence, next by association for defence as under the Feudal System, finally by the collective force and authority of the community, in the enforcement of its law. Such has been the evolution because every one of these suppressed wrongs has given birth to a co-related right—the right of quiet possession, the right within limits of unmolested user, the right to prevent, or to recover compensation for damage, the right to forbid trespass.

Out of those rights has arisen the initial value of land as wealth. It is evident that apart from such rights land could have no actual value. A title to land is a title to the rights. Manifestly the value of the rights has risen as they have become more completely guaranteed.

With the evolution of these rights we have the evolution of tenure. Much discussion has arisen on whether land ought to be in public or in private ownership. As between the two the world is divided. Public ownership is the rule where the Asiatic type of civilisation prevails; private ownership where the European type has established itself. But even in Great Britain and other European countries, the ultimate ownership lies in the State, and private ownership is, in theory, a tenure only.

In practice, none the less, the occupation of land is and must be everywhere that of individuals, families, or village communities, and economically ownership and tenure resolve themselves into the question of

what, in any given state of society, tends best to promote land improvement, and to bring land into the best use. Under any system, before occupiers, whatever their theoretical title, will improve, they must be reasonably assured that they will not be robbed of the fruits of their improvements. A system which fails to afford that assurance is economically evil. Under such a system the wealth already sunk in improvement will assuredly be lost.

Such wealth, as pointed out, is a very important part of any community's active capital. For example, if a man works or lays out money in draining, planting, irrigating, making better approaches, or building barns, and on account of that work or outlay has to pay in higher taxation or higher rent a quittance that absorbs all or nearly all, or even a large part of the benefit, the demand is really a tax on his industry and energy, and when it is not worth his while he will cease to be industrious and energetic. In that way by unjust laws or usages, habits of idleness and lack of foresight may be engendered in a whole people. But the value of land does not merely depend upon rights and improvement. It is added to by public roads and railways, since these speed up production by facilitating exchange. Exchange, too, has been the origin of market towns and cities, which as foci of exchange have usually become foci of non-agricultural industry, the market towns gathering up the business of the country and the great cities that of the market towns.

Land under these circumstances has come to have a situation value quite apart from its natural fertility.

It is from situation worth more when readily accessible from great roads, railways and navigable rivers. For the same reason it is worth more in a market town than in the country, more in a city than in a market town. In great cities like London and New York its value is immensely high.

But there is yet another value element—the minerals under the land. Deposits of coal, or iron or other metallic ores, of salt, fine clay, limestone, silica, or oil, strata of slate or stone adapted for building—all these, where found, form another element of value.

**We have thus entering into the worth of land five different elements—security of rights value; fertility value; improvement value; situation value; and mineral value.** But every one of these kinds of value depends on men themselves—upon their regard for law; upon their agriculture; upon their foresight; upon their activity; and upon their inventiveness and skill. There is truth, therefore, in the French proverb that the more a man is worth, the more his land is worth.

Rent of land is another of the points in Economics which has given rise to much controversy. The chief difficulty in understanding it is removed, however, by remembering that **rent is analogous to interest.** The holder of land foregoes possession for a consideration just as the possessor of money foregoes possession for the same reason. Like the user of the money, the user of the land is loaned, and in the one instance, as in the other, the taker of the loan enters into the transaction in order to derive advantage from it. And the tenant of the land, like a prudent borrower

of money, applies the loan as active Capital for the time being. In the case of a loan of money the return is reckoned as so much per £100, or per $100; in the case of land it is reckoned as so much per acre or per hectare per annum. The analogy between rent and interest is very close.

As to the rent of land all the elements of value which apply influence the transaction. Security, or insecurity, fertility or the reverse, adaptability for this or for that class of farming, situation as regards markets, cost of improvements carried out by the landlord, and finally the average working profit made by an ordinarily careful and competent tenant—all these go to raise or to lower the rent. Rents rise with improvements in transport and exchange because land values rise from the same causes, and agriculture profits at the same time. Conversely with impediments to exchange, and increase in the costs of transport, rents and land values fall.

To discuss rent as a purely abstract proposition gives rise to obscurity because there are rents and rents, and the distinctions between them are definite. The rent of buildings, for example, while in part a charge for the user of the site, is mainly a return on the cost of building, and is exactly on all fours with the return on any other active Capital. In parts of Great Britain it is the usage to let land suitable for building sites on lease, the consideration being a ground or site rent with the stipulation that a building or buildings of a certain character or value shall be put up. The practice has been encouraged by the feature of English law which on the expiration of the lease gives the lessor

all buildings or fixtures on the land without compensation to the lessee. This law has largely been responsible for the comparatively mean aspect and architecture of most English towns. A lessee does not put up solid, elegant and enduring buildings in order that they may pass to the site owner. He puts up what he is compelled to put up so far as it serves his turn. His security, in short, is a limited one. No law can in the long run extract something for nothing.

Another kind of rents are mineral royalties. The landowner lets the minerals or stone or other workable deposits for a payment per ton. Mineral royalties have arisen out of the law that everything on or under the land is the property of the landholder.

Yet another kind of rents are market tolls, a return on the cost of laying out market sites or erecting market buildings. Sometimes, however, these rents are "franchises" like the privilege of collecting tolls on roads or bridges.

The proposition that rent arises out of the surplus product of agriculture left after payment of the wages of labourers, and a profit sufficient to induce the farmer to farm, puts the question in a form needlessly difficult. Rent is of course paid out of such a surplus, but it is not the basis of rent. If it were the landholder would have to adjust his rent to loss as well as to profit. There is such an adjustment in the metayer system on the Continent of Europe, where the rent is half the year's produce, but the metayer system is a survival from the times of Roman serfdom. The truth, as said, is that rent is analogous to interest.

Often enough the question has been raised whether

rent of land ought properly to be paid at all. Land, it has been contended, is a gift of Nature, and rent a mere charge on the footing of monopoly of this gift, and as a toll upon produce, a tax levied by private persons on the labour of the community.

Further, it is said that land is limited or fixed in quantity and that limitation marks it off from other factors of production. The statement has been accepted as an economic truism. Thus crudely insisted upon, however, the statement is not true.

To begin with **every improvement and intensification of agriculture is equivalent to an increase in the area of land.** In the matter of produce it not only comes to the same thing if the same amount of produce is got from two acres or twice the produce from one acre, but it costs less in ratio to result to farm intensively than to farm extensively.

Next **with every improvement of transport land is and can be brought into cultivation that either would not be cultivated at all, or but sparsely occupied.** Transport levels up differences of situation and situation value. And that applies not only to land transport, but to sea transport. Sea transport has enabled distant lands to be colonised and turned to use.

Thirdly, **only the smaller part of the land of the globe has so far been turned to account in production, and even that smaller part is by no means fully utilised.**

The time when the limit of occupiable land will have been reached, and the limit of advancement in cultivation reached, is very, very far off.

Further, when it is said that land is a gift of Nature, the obvious reply and the fact is that it is, but the gift of Nature is not improved land; the gift of Nature is swamp and prairie and wilderness.

It has, however, been contended, and notably by Mr. Henry George, that as the value of land under every head rises with every development of production and exchange, and with every rise in civilisation, the holders of land are enabled to exact an increasing share of the results of production. That, he has urged, is the true explanation of the contrasts between wealth and poverty, and there are those who hold the opinion that were this toll transformed into public taxation all other taxes could be abolished.

Now socially as well as economically the desiderata are (1) that land should as far as possible and as rapidly as possible be improved; (2) that it should be cultivated to the best advantage; (3) that the user of it should be as free from hindrances as possible; (4) that its transfer should be as simple and inexpensive. Looked at without prejudice the question is whether the system which has grown up with the European type of civilisation stands in the way of these aims or does not.

If a public land administration could be assured at once honest, economical, and free from favouritism and red tape, it might be desirable to buy out the holders of land with issues of public stock, and out of rents to liquidate such stock over a series of years by means of a sinking fund.

Unfortunately such an administration cannot be assured. There is no guarantee that its cost would not

add to existing rents, for rents would then cease to be influenced by economic causes, and become subject only to political considerations. Further, the body of occupiers would even more than at the present time form a powerful vested interest, directly concerned, as an interest, in political wire-pulling.

Next, as in Asia under State ownership, there would have to be security of tenure or improvement would come to an end, or have to be defrayed out of public resources. **But a State tenancy with security of tenure would be a freehold in everything save the name.** In fact, a freehold is nothing else. Would land under such a system be cultivated to better advantage? Not necessarily, and certainly not if there were much official interference. Would the user be freer? Not necessarily. Would transfer be simpler and less costly? Not necessarily. The virtue or vice of ownership would depend, just as it depends now, on the owner.

The kind of rent which most savours of monopoly is that based on situation value, particularly if enhanced, as it nearly always is, by public improvements. So far as can be estimated the latter might be claimed by the public. But unless strictly safeguarded, the claim would become a mere impost on user, and if it operated as a tax on dwellings would be an impost on one of the necessaries of life.

Situation value and its increase might be dealt with by empowering municipal corporations to acquire land within their boundaries. This the law of England at present prohibits save for certain specified purposes of public utility.

In any particular instance situation value is determined by the balance of advantage. Under free contract charges cannot rise higher than the economic advantage of the site warrants. The difficulty attending all such suggested solutions as nationalisation or municipalisation, is that free contract would be replaced by monopoly actual and practical and not merely theoretical.

Now every monopoly implies restriction, and it is because there would be practical monopoly that the State or the city owner might seek to extract more than the economic rental.

# CHAPTER VII

## EXCHANGE AND CURRENCY

Economic Benefits of Exchange—With Civilised Life Specialisation of Callings more Extended and Complete—Specialisation a Saving of Time and Effort—Its Meaning in Terms of Human Welfare—The Evolution of Exchange—Money as a Medium—Its Utility—Analysis of Exchange—The Economic Motive of Exchange—Mutuality of Advantage—Effects of the Use of Currency on Serfdom and Villeinage—Origin of Acceptances and Bills of Exchange—The Mercantile Code—Circulation of Bills of Exchange—Currency Debasement Origin of Sterling—The Sterling Bill the International Money of Merchants—Commercial Utility and Importance of Discounts—International Trade, like National, Carried On Through a Medium—Illustrations of International Exchange—International Trade has the Freedom and Facility of Sales and Purchases for Money.

EVEN the most superficial study of production serves to disclose its dependence on exchange. Apart from exchange the development and growth of production could not have taken place. Men live therefore not merely by producing things, but by exchanging them. **By exchange the powers of one man become, in results to himself, varied by the powers of a multitude of men.** There is no man in any civilised country who for the satis-

faction of his needs and wants does not habitually and as a matter of course rely on work contributed to not by hundreds of others, but by thousands. The food on his table, gathered from all parts of the world, has been grown, prepared, packed, transported and handled by many hands; a hundred men have helped to make the watch in his pocket, or the boots on his feet. It is the same with the crockery and pots and pans he uses, and the rest of the furniture of his house. His clothing equally represents the labour and skill of a thousand producers. The contrast with his condition had he to supply his own wants and needs unaided is so wide that it calls for a very lively effort of imagination even to grasp it.

Increasingly as civilisation advances men thus rely more and more upon each other. In turn each more and more follows some one particular calling. **In short, with civilised life specialisation becomes more and more extended,** and Jacks-of-all-trades, who can do nothing in particular, less in request. More and more is the man in demand who can do some one thing well; most in request of all, the man who can do some one thing supremely well.

It has been over and over again asserted that civilised life tends to stamp out character, and make men more alike. That conclusion is superficial. The real effect and influence of civilised life makes for variety and distinction of character and differences of talent. It is in civilised life that talent of every kind has the widest field. The force of custom and usage is strongest in savage life and among the uneducated. In savage life custom is cast-iron. Even

among barbarians it is still despotic. In this respect civilised man in civilised society alone enjoys comparative freedom, notwithstanding that habit and convention persist.

What has been the cause of this great change? The cause has been that the change represents a saving.

Consider the saving in effort and in time as between the condition of the man who has to supply all his needs and wants unaided, and that of the man who through exchange can rely on a multitude. In the first case his wants would have to be vastly reduced even if to supply them he worked every hour of every day, for of the things he can command in civilised life even with modest means 99 out of a 100 would be beyond him. In the second case he has all these things, and he has them for a contribution in work of some kind that takes up only part of his day.

**Next consider this individual saving of time and effort multiplied millions and millions of times over, since it applies to all men and to every man, and then think of what it means in terms of human welfare.**

Why has the saving gone on? Because not only by sub-division of labour and exchange of the results is more produced with less effort and in less time; specialisation of callings is release. It affords leisure, and in the mass it has meant greater happiness.

Exchange, based upon accepted measures of weight, length, and quantity has been greatly aided by the use of money, and it has gone through the following stages:

First came the exchange of one thing for another:

primitive barter. Next came the agreement that something *A* was worth something else *B*, and that as a third thing *C* was also worth *B*, *A* was worth *C*: developed barter. The something else came to be a precious metal. Owing to the use of precious metal for the purpose we have the third stage: that a difference in the worth of any two things might be made up by a payment in precious metal. The fourth and final stage came when a seller sold for money and used the money to buy. This last form, bargain and sale, is exchange as we know it, and it is important to note that bargain and sale is the only form in which civilised men carry on their transactions whether national or international.

As compared with barter, bargain and sale is also a great saving of time and trouble. That saving is the real utility of the use of money as a medium. A butcher, for example, wants for himself and his family many other things besides meat, and a baker many other things besides bread. If each, in order to obtain those other things, has to go round bartering his meat or his loaves, time would be lost and effort increased. And it is the same with all transactions whether wholesale or retail. **The use of money then saves time and labour, and has greatly speeded up exchange and made it more certain because money is a convenient, portable, and immediately available title to goods or services,** and a title based on the equivalent worth of goods sold or services rendered.

In its final analysis exchange in every case is an exchange of services for services, for goods are always

the outcome of services. Exchange, therefore, may be either an exchange of goods for goods ; an exchange of services for goods ; an exchange of services for services ; or an exchange of services for goods. The use of money assists these dealings, which, using the symbol ∞ as "the equivalent of," may be represented thus :—

$$\left.\begin{matrix}\text{goods}\\ \text{and/or}\\ \text{services}\end{matrix}\right\} \infty \text{£x} \infty \left\{\begin{matrix}\text{goods}\\ \text{and/or}\\ \text{services.}\end{matrix}\right.$$

For example, a man sells meat for money, and with some of the money buys groceries or chandlery ; exchange of goods for goods.

A man works a week and receives a wage for his work ; he lays out his wage in food, etc. ; exchange of services for goods.

A man sells goods and out of the proceeds employs and pays for labour ; exchange of goods for services.

A man out of his earnings goes on a railway journey, or being ill calls in a doctor ; exchange of services for services.

In all these instances money is the agreed measure of the value given or received, and the medium of the exchange. Exchange carried on by means of such a medium is very flexible and adaptable.

Now there is one thing concerning which before going further it is vitally important to be quite clear, and that is the motive for exchange. **The motive is advantage ;** the advantage, however, is not on one side only. As a rule it is considered by each party to be on his side ; but as a fact, dishonesty apart, it

is mutual. **Mutual advantage, actual or supposed, is the motive for all exchange, from the sale and purchase of a penny candle to the sale and purchase of a ship's cargo.**

Neglect of or denial of that perfectly simple and universal truth has led to the diffusion of more nonsense, the enactment of more bad legislation, and the fighting of more wars than anything else in the sad record of human folly.

Let us revert for a moment to the history of money, for it has a very remarkable history, and though by no means a cheerful, yet an instructive one.

Money as first used in Europe was copper, for the age in which copper money alone was used in Asia is older than history. But as first used in Europe for purposes of exchange copper was in bars or pieces, and those pieces which passed by weight, were pounds, a term derived from the Latin *pondus*, a weight. The term still survives in the pound sterling, since it is supposed to represent, though in gold, the old copper *pondus*. Next, as already said, the bars were stamped as a guarantee both of weight and of purity. But since the use of money, by speeding up exchange, increased both production and consumption, transactions grew more important, and pondera of copper inconvenient, save for small dealings. So silver, the coin of Asia, came into use, as still more precious but less in weight and bulk. As transactions went on growing, silver in turn became inconvenient. Hence gold came into use as again more precious.

In common use during the flourishing times of the Roman Empire, both gold and silver coinage, after

the break-up of the Roman power, became very rare, and virtually disappeared, finding their way little by little to the East. In England and most other European countries the only coinage in common use was again copper, and it was not until the sixteenth century that silver even began once more generally to be coined. Its use was greatly widened by the discovery of America, which also somewhat later reintroduced the use of gold.

One of the social effects of this increased use of money in Europe was to hasten the disappearance of serfdom and villeinage. Men being necessary to work the land and there being no money in which to pay them, the only way out of the difficulty was to tie them to the land, and compel them to render services paid for in kind. Such services by slow degrees became regulated by custom, and a usual part of the wage was an allotment. So rose villein tenures. But when money became more common and the restrictions of villeinage customs irksome, and a drag upon agriculture, it proved more economical to engage labour for cash payments. Thus serf labour passed gradually into free labour, and serfdom into wage employment.

This important result of the freer use of currency has not had the attention it deserves. **Wherever currency is abolished there conditions of serfdom inevitably arise.** On the other hand, the use of a reliable medium of exchange is a powerful promoter of free contract. This has again been illustrated in present-day Russia.

We have, however, still to touch upon another development of exchange of equal if not greater

consequence. At the date when in Europe silver and gold began again to be employed generally as currency, it was still unsafe to carry sums in precious metals from place to place. Brigandage remained common. To get over that obstacle, merchant adventurers, who at all times have been the pioneers of commerce, formed the practice of depositing in a place *A*, from which they intended to set out, the money with which they proposed to buy merchandise in place *B*. The money was deposited at *A* with an agency in correspondence with a like agency at *B*. On deposit made, the merchant received, less a charge for the service, an acknowledgment in the form of an order on the agency at B to repay him. At *B*, on presenting his bill of exchange, as such documents came to be called, he received his money. He was thus saved the risk of carrying it with him, and as the charge for the service was small compared with the risk, the practice became the general custom of merchants. The agencies referred to were the earliest modern banks, and were first established in Italy.

This practice of employing bills of exchange to remit money from place to place—the agencies balancing up accounts between themselves at stated intervals—gave rise to a code of mercantile usage and the effect of the code was to make bills of exchange, as representing money, the equivalent of money by putting them into circulation like money. The earliest kind of bill, just described, is now called an acceptance, since it was drawn on a bank, and on behalf of the customer accepted by the bank, subject to the customer's liability to refund them. But another kind of bill of

exchange later came into use, and this is now the common form. This kind of bill is drawn by one merchant or trader on another, and accepted by the drawee as he is called. In accepting he admits the value received for the claim upon him, **and the admission is binding.** Such binding admission is really the essential feature of the document.

A bill of this kind is commonly discounted, that is, sold, less a charge for the advance of the money, called the discount, for these kind of bills are, like acceptances, payable after a specified interval, thirty, sixty, ninety days, or six months as the case may be. So sold, either directly to a bank, or more usually to a discount house, the bill is put into circulation and passes from hand to hand as the value of its amount. It is of course a debt receivable. But it passes from holder to holder by endorsement and under the Mercantile Code every successive endorser becomes a surety for the eventual payment, for if the drawee, as the acceptor is called, fails to meet it, the last endorser can be called upon and so on. Thus the more endorsements a bill has on it the better security it is. That custom of merchants contributes to the ready circulation of bills until the time of payment arrives.

Now just as the acceptance originated in the desire to avoid risk of robbery, so the reason for the adoption of the later form of bill was to get over another obstacle. That obstacle was the debasement of currency. In the Middle Ages, when the use of precious metals as currency again become diffused, governments everywhere took over and monopolised the business of coinage. They proposed to safeguard the public

against fraud. But it speedily appeared that needy and extravagant governments were themselves not above perpetrating fraud wholesale. The coinage was constantly being reduced both in weight and purity.

The effect of such a reduction can be very shortly stated. Let us suppose the total coinage of a country to be equal to £3,000,000. If each unit of the currency be halved in value, either by reduction in weight or by means of a base metal alloy, the total can be nominally increased to £6,000,000, and the government "makes" £3,000,000 on the change. And that was the regular way in which during the Middle Ages governments who wanted money raised money. True, of course, the new coinage was worth, piece for piece, so much less, and in terms of the new coinage, the cost of everything went up. The fraud told most severely on the poor since their earnings in money did not go up as fast as prices. Occasionally the practice led to famines.

Partly to circumvent the effects of these practices on trade, the free cities of Central and Northern Europe, then the chief seats of industry and business, formed the Hanseatic League, and one of the compacts of the League was that the debased currencies of neighbouring governments should not be accepted. The only money recognised by the Easterlings, as the Leaguers came to be called, was their own standard money, which came to be known as sterling. Other money was only dealt with according to the weight it contained of pure or fine precious metal, and as bullion.

The effect of this was that bills of exchange came to be drawn and payable in sterling, and traders, in selling goods, preferred payment in sterling bills rather than in currencies of uncertain value. **Such bills therefore came to be the international money of merchants.**

On commerce as carried on between country and country, this use of an international medium of exchange, representing money, and convertible into money, has had an effect as far reaching as the use of money in national life. And it has had the same effect from the same causes—certainty of reckoning ; facility, and not least, economy, since it has had the very important result, through the practice of selling and circulating bills, of enabling merchants to transact a very much larger volume of trade on a given amount of capital. For instance, if a merchant, while allowing a customer three months' delay in payment, can sell the bill accepted by the customer, then he has not to stand out of his capital in the meantime. And not having to stand out of it, since on the security of the bill it is advanced by the bank, or by the discount house, he can use it to finance another transaction. So, with the same amount of capital, he may in three months finance a dozen, or a score of transactions, where otherwise he could only have financed the one.

The practice just described thus, on the one hand, promotes trade, and through trade, industry, and on the other, through the banks and discount houses enables a very large amount of what would not otherwise be active capital to become active. Though

the rate of discount charged is low, the turnover of capital is in ordinary times regular and rapid.

In some treatises on Economics international trade has been spoken of as barter. **But the method of carrying it on is not that of barter.** As a fact it is, just like national trade, an exchange of goods and/or services for goods and/or services, and it is carried on in exactly the same way through a medium —the bill of exchange. The bill of exchange gets over the difficulty presented by the nationality of currencies. It is, in short, an instrument not only for the transfer of claims, but for enabling a sum of money stated in one currency to be paid in another.

Let us take an illustration. *A* is a merchant whose business is to import wines from France. He pays for the wines by accepting the bill of the French exporter. On receipt of the bill accepted, the French exporter sells it and receives its value, less discount, in francs. In due course the equivalent of that sum in francs is deducted from *A's* balance at his bank. Here the wines imported have been paid for in francs changed in due course into sterling, and the bill is the medium by which the change from currency into currency has been carried out. But let us go further. *B* is an English trader who exports textiles to France. He receives in return his bill accepted by the French importer. In like manner he sells the bill and receives sterling for it, and equally in due course when the bill is met the French importer discharges the debt in francs.

Now that, of course, is an exchange of wines for textiles, for the banks in London and in Paris balance

the purchases one against the other. If they are for an equal amount the transactions mutually cancel out. The exchange is only barter in the same sense as that of the baker who sells loaves and buys groceries can be said to barter loaves for groceries. If for his loaves the baker were offered, say, packets of candles he did not want, he would be in a difficulty. Just in the same way the exporter of textiles to France would be in a difficulty if offered wines he did not want and did not deal in. All that kind of difficulty the bill of exchange as a medium does away with. The use of bills therefore gives international trade all the freedom and facility of sales and purchases for money, and as a fact most importers in all countries are merely importers and most exporters merely exporters. Adjustment is a banker's business with which merchants, save as customers of the banks, are not concerned.

# CHAPTER VIII

## CREDIT AND THE FUNCTION OF CREDIT

Definition of Credit—Instruments of Credit—The Mercantile Code the International Charta of Commerce—Negociability—Origin of Bank Notes—"Cover" and Convertibility—The Structure of Credit—Origin of the Cheque System—Advantage of the Use of Cheques—Ratio of Legal Tender Currency to Commercial Turnover—Credit System Economises Currency and Facilitates Exchange—Modern Currency Debasements—Issues of Legal Tender Paper Money—Inflation and its Consequences—Public Loans without Interest—The Supposed Creation of Banking Credits—Its Real Meaning—How Active Capital is Liquidated for War Purposes—Resultant Increase of Legal Tender Currency—How Forced into Circulation—"Fiat" Money—Its Effects on Contract—And on Prices and Wages—Ordinary Banking Credit not Inflationary—Distinction between Legal Tender Currency in Gold and in Paper—Instruments of Credit when Based on Value do not Affect Prices—Effect of the Use of Instruments of Credit on Industry and Trade.

ONE of the leading developments of Credit has in the brief description given of Bills of Exchange already been touched upon. How world-wide has been its usefulness, and how true it is to say that Bills of Exchange are the international medium of trade and the world's commercial currency may be gathered

from the fact that when the Great War broke out in August, 1914, there were in circulation in different parts of the world sterling bills drawn on London to the amount of £400,000,000 in addition to the bills of exchange in circulation in Great Britain itself. Besides these there were of course the outstanding dollar bills, mark bills, franc bills, etc., though not for so large a total.

The exchange transaction of purchase and sale so far touched upon is that known as a "cash" transaction. In such a transaction there is a money payment forthwith. But in a credit transaction goods are delivered, services rendered, or a title to goods and/or services granted in reliance on a promise to pay. The receiver of the goods, services, or title to them, is in the meantime credited, or trusted. **A credit then is a right or title to value granted by the creditor as holder of the right, on condition of the return of its equivalent at some future stipulated date,** and because of the obligation to pay back the equivalent, the grantee is called the debtor, or ower.

And **an instrument of credit** is a document declaring or defining the right granted, and as it sets out the debtor's acknowledgment, is to all intents the title deed of the right.

Two of the reasons why acceptances and bills of exchange came into use have been stated, but it should be added that in all civilised countries **the customs of the Mercantile Code** have, on all essential points, been given the force of law, and that **this Code is in truth the International Charta of Commerce.** One of the most important points of

the Code is that which clothes instruments of credit with the same legal characteristics as money, and therefore makes them for every practical purpose the equivalent of money. And to every civilised country of the modern world recognition of the Mercantile Code has become of the greatest economic consequence. In Russia repudiation of the charta of commerce was followed at once by economic distress.

Now the main legal characteristic of money, and one which marks it off from nearly every other description of property, is that it passes from hand to hand for value. In other words, if it be honestly come by, the holder of it cannot be claimed against by a person who may have lost it, or have been robbed of it. If the holder has given value for it, it is his finally. That is not the case with other property. For instance, where a coat has been stolen, and somebody buys the coat from the thief, the original owner can claim the coat notwithstanding, unless the sale has taken place in one of the places called in law open markets where the buyer may reasonably presume that goods offered are not stolen property. It is this characteristic of money which ensures its ready circulation as currency. Money is, in legal phraseology "**negociable.**" In like manner instruments of credit are negociable, and pass for value given from hand to hand. The title of a holder who has given value cannot be questioned. The object of course is to enable them, like money, to circulate readily. Hence the holder of a bill of exchange, if he owes a debt, can pay the debt with the bill by endorsing the instrument, and passing it on.

This, however, has not been by any means the only development of credit. Another has been the practice of issuing **bank notes.** The banks, as agencies for the transmission of money, in due time became agencies for deposits of money by persons wishing to put savings in a safe place, and the banks attracted such deposits because, as they could turn them from passive into active capital, they could pay depositors a return. In turning deposits from passive into active capital, the bankers lent out the money to borrowers of reliable character able to make good use of it, and as in course of time a vast amount of money came thus to be turned into active capital, on the one hand trade and industry were encouraged and opportunities opened out for character and ability, while on the other hand depositors had the benefit of interest earned.

When deposits were received it was the practice to give an acknowledgment or receipt, and such receipts were passed among business men from hand to hand as documents of value. For the purposes of business dealings and settlements of many kinds they were even handier than sums of money in coinage. Such was the origin of bank notes. But also, and for the like reason, it became the usage of bankers, in making advances, not to loan in the form of actual metallic currency, but in the form of their own bank notes. A bank note is merely a certificate that the issuing bank, whenever the certificate is presented, will, on demand, give the holder—who, as already said, is in law presumably a holder for value—actual metallic cash for it. Since, then, such notes both represented cash deposited, and were cashable on presentation,

they circulated as readily as cash itself. In technical language they were both "covered" and "convertible," and like cash, "negociable." These characteristics ought to be, and are, those of all sound bank notes.

Now the effect of issuing bank notes was, to the extent of deposits, to substitute currency in the form of notes for currency in the form of coin. It was found that for large transactions involving immediate payment notes were much more convenient even than gold. But experience also proved that the number of holders of notes who on an average and in any given time presented them for conversion into cash, were only a percentage. Hence, if need were, tho total of notes in circulation might, in ordinary times, quite safely be larger than the cash kept in hand. The cash kept in hand came, therefore, to be treated as a reserve.

In these circumstances a banker would be a creditor of those to whom he had made advances, and a debtor to his depositors, and to holders of notes. As said, in ordinary times this balance of credits and debits was safe enough, and to the banker it was profitable, since he received a higher rate on his advances and discounts than that paid on deposits. His earnings, needless to say, were earnings for services rendered and risks taken.

Reference has been made to the remarkable social changes brought about by the more general use in Europe of coinage and currency, and it has been shown how such instruments of credit as acceptances and bills of exchange enable merchants to carry on a much

larger volume of trade with a given capital. The use of bank notes in making currency go further had effects on trade, and through trade on industry, hardly less marked.

The total of deposits of savings in the banks very soon passed the total of coinage in circulation. At the present time, for instance, in Great Britain the total is about eight times the whole amount of the legal tender currency and the excess arises from the fact that money is a medium. To give active effect and employment to these deposits means have to be found for making them function as a medium just as much as legal tender currency. Acceptances and bills of exchange are such means, and the use of bank notes is another.

At the end, however, of the eighteenth and the beginning of the nineteenth century, when owing to its utility and profitableness, the practice of issuing bank notes had become general, and most of all in Great Britain, there were at intervals severe commercial and monetary panics. The structure of Credit, as yet not very solidified, was shaken by political disturbances and checks to trade. At such times holders of notes rushed to the banks to cash their paper, and at the same time, depositors, sharing in the common nervousness, desired to withdraw their deposits. Legally they were all entitled to be paid in coin, but of course there was not coin enough to pay them, and there is not coin enough for such a purpose in any country at any time. In fact, if everybody were to hoard money, the legal tender currency would have to be multiplied times over, and the differ-

ence would be that instead of this saved capital being active, and employed in industry and trade, it would for the most part be passive and idle, and earning nothing. Economically the difference would be enormous. No part indeed of the economic progress of the modern world has been more vital or more beneficial than that represented by the devices which on a comparatively limited total of legal tender currency, have enabled a vastly larger amount of savings to be actively utilised through reliance upon the validity and good faith of contracts and engagements.

In times of panic that reliance is weakened or in part gives way, and in the panics of a hundred years ago, banks who had lent rather freely, in face of the "run" upon them, soon found their cash reserve exhausted, and had to close their doors. In view of these experiences bankers adopted two other expedients. They kept part of their reserve on deposit at the Bank of England, and they invested another part of it themselves in readily saleable securities, such as Government stock, so that, in case of stress, they could always find cash enough to re-establish confidence.

It was from these developments that the Bank of England came to be the "bankers' bank," and that banks came to be more closely associated together, recognising that it was to their interest to stand together and to come to each other's assistance in case of need. Long before the formal amalgamations of recent times, there were informal alliances. There is, in fact, a very great difference in point of strength and stability between a banking system in which each bank is an isolated unit, and a system in which, form-

ally or informally, they are linked up. As the whole structure of credit is reared upon confidence, and the advantages of it economically are very great, it is of the utmost importance to prevent that confidence from being impaired. Where banks are isolated one from another the credit resources of a country are dispersed, as it were, into a number of comparatively small and unrelated pools, and there is a considerable risk of some of them drying up. But when these pools are inter-connected they form in effect a great reservoir, and risk of failure is for practical purposes eliminated. This is illustrated by experience not only in Great Britain but in the United States. Until late in the nineteenth century banking in the United States continued to be carried on mainly through very numerous, and for the most part independent, private banks. In times of monetary strain failures were serious just as they had been in England in the like circumstances. After the last of these panics, that of 1907, the advantages of linking up, realised in England, began to be appreciated, and the United States Congress finally passed the Edge Act, which established, under public guarantee, Federal Reserve Banks controlled by the public body known as the Federal Reserve Board. In the event of stress, ordinary banks always have this backing to rely upon. The result has been not only to make the United States banking system an organic whole, but to do away with panics.

In England, taking the cause of the difficulty to be the unrestrained right to issue bank notes, though as a fact it arose rather from the lack of union among

the banks themselves, Parliament in 1842 restricted the right of issuing notes to the Bank of England, and to such other banks as then held and exercised it. No new bank could issue, and in the case of the Bank of England the Bank Charter Act laid down that notes must be issued only against a specific cover of gold. The Act led to prolonged controversy, one reason for which was that the restriction on note issues was a real public inconvenience. Such representative paper currency had become a business necessity, and the only way to make the deposits of ordinary banks effective was for such banks to take their gold, as they received it from the public, to the Bank of England and take out notes. But even that left the note issue restricted to the total of gold in circulation, and the gold in circulation was of course no more than a fraction of the total of deposits ; and much less even than the total of advances.

The inconvenience, however, like earlier inconveniences, was got over by another development of practice—the use of **cheques.** By means of cheques each customer was enabled to draw upon his account as desired. Cheques, in fact, served the same purpose as notes. But they served the same purpose—the representation of money—even better, for **a cheque is nothing more than a bill of exchange drawn upon a banker and payable on demand.** It has the advantage of a bill in standing for value, and the advantage of a note as being convertible. For all the purposes of national industry, trade, and exchange, the cheque has proved entirely adapted and adaptable.

Bills and cheques have eked out the legal tender

currency and made it go round, and their importance may be inferred from the circumstance that before the Great War only one-hundredth part of the annual turnover of money in Great Britain was in coin, and ninety-nine hundredths in bills, cheques, and notes. The transfers of cheques from person to person, are just like the transfers of bills, balanced against each other, and though the turnover of money is thus represented, actual money does not pass. It need hardly be added that **these devices have immensely facilitated exchange.**

Why the devices of credit have facilitated exchange may be very simply illustrated. Suppose a man has a ton of coals and sells it for, say, £3. He can lay out the £3 in any way he chooses, and what this means is that he is enabled through the medium of money to exchange his coals for anything whatever which can be got for £3. Again, suppose a man works a week and receives a wage of £5. He also can lay his £5 out as he chooses, and the meaning, once more, is that he is able to exchange his services for whatever the wage will command. People are so used to all this that they rarely or never stop to think how very remarkable an economic evolution it stands for. When, therefore, it is said that the general use of money has had far-reaching social effects, the statement is, plainly enough, not an exaggeration. The use of instruments of credit stands for a yet wider and more general use of money, and the social consequences have been pushed yet further. In other words, an immensely multiplied volume of exchange dealings can be carried on in the shortest time and with the minimum of risk,

and that has reacted upon and developed production and transport in all sorts of ways.

We now come to other aspects of exchange which the Great War again brought into prominence.

To function as a medium of exchange, and as the basis of the structure of credit, money should have as steady and assured a value as possible. It was because of their supposed steadiness of value that the precious metals were adopted for the purpose. When, however, in place of a precious metal, we have substituted a medium that can be multiplied at will, the assurance and steadiness of value is evidently not the same. It is like substituting an elastic yard measure for one that is inelastic. If the elastic measure can be stretched to double the former length, then a seller of cloth, to protect himself, will ask double the former price per yard. Thus in the new measure the price becomes twice as high.

Reference has been made to the practice on the part of European governments during the Middle Ages of debasing their coinage. In that case the debasement was clear enough to everybody. But the resultant use of instruments of credit suggested during the eighteenth century another method of debasement not so evident. This was the issue by or on behalf of governments of **paper legal tender currency.** Such a currency is legal tender when people are by law compelled to take it in payment of debts, and to take it at its face value. By such means it is "forced" into circulation. It becomes, as has been said, "**fiat**" **money.** Where notes of that kind are convertible on demand into a precious metal equivalent—gold or

silver—they do not differ from ordinary bank notes. But the common characteristic of "fiat" money is that it is not convertible. There is nothing behind it save the authority of law.

On a considerable scale this practice was first resorted to by the British North American colonies during the war in which they gained their independence, and it was copied by the Government of France after the first French Revolution. Since 1914 it has been resorted to by every government in Europe, and on a scale never before known.

By the issue of "fiat" money a government is apparently able to command goods and services at no greater cost than the printing of its notes, and this looks like a ridiculously easy and simple mode of raising revenue. But what happens when the total of legal tender currency is by these means multiplied? **The prices alike of goods and of services go up in the terms of the currency.** Let it be supposed that the currency is by these means doubled. Then, though perhaps not all at once, the cost of everything in the terms of the currency will go up to double at least. Similarly, if there be a tenfold multiplication, there will be at least a tenfold rise in nominal prices and expenses. That, however, really and in truth means nothing more than that each unit of the currency so multiplied buys only one-tenth as much. In other words, it means that the currency has been debased. No more is obtained by anybody than before, because if things are sold at ten times the price, the price received is worth only one-tenth.

As a fact this mode of raising revenue is merely a

roundabout device of taxation. The government gets goods and services, and apparently for nothing. The nothing, however, is but a semblance. The real payment for the goods or services is distributed among the public in their money not going as far. Everybody in that form contributes something.

Issues of "fiat" money have also been described as **loans without interest forcibly raised from the public.** It is a correct description, because the notes are issued not as mere pieces of paper, but as documents of value, the value being the implied promise at some time or another to redeem them in genuine money. They are therefore I.O.U.'s issued on the strength of the public credit. By the device of "fiat" money a government may incur expenditure over and above ordinary revenue where the latter has already been fully drawn upon.

Much discussion has taken place as to the effects of such inflations of currency on the costs of commodities and the cost of living. There is no need to be technical and intricate in dealing with the matter. The only call is to be sensible and plain.

There is first the effect on the balance of production and consumption.

By means of such issues of paper money a government enables the persons whose goods or services it thus pays for, to become consumers. It therefore sets up a new demand for commodities, direct or indirect. And if, as nearly always happens, such issues are brought into existence to facilitate consumption that would not otherwise take place, that extra consumption, it should be clear, can only occur at the expense of the

remainder of the public as consumers. Usually too, and more especially in the case of war, this extra consumption is accompanied either by a decrease of production, or by a change of production to destructive ends. The ordinary economic balance is upset alike by the curtailment of the useful production which makes for welfare, and by a blowing up of consumption. Every individual either employed by a government, or receiving money from a government in a capacity that does not in some way create value, is withdrawn from the ranks of producers, yet remains one of the total of consumers. It follows that such persons are living on the rest of the public.

There is next the effect on contracts and engagements.

Where the value of a legal tender currency is altered, every contract or engagement involving the payment of money is altered at the same time, and to a like extent. Every creditor is defrauded. But owing to the risk this imports into contracts and engagements the charge for risk goes up, and in the long run everybody is a loser. The evil influence of currency inflation on contract infects and weakens the whole structure of credit.

But inflation does not now, as a rule, take place in the old crude form. In most modern countries, and particularly in countries like Great Britain and the United States, the total even of liquid capital is greatly in excess of the legal tender currency. It has been supposed that this excess in part represents the manufacture of credit on the part of bankers, and by the simple process of entering advances to customers in

their books. That, however, is not the case. Credit granted by a bank represents money deposited. It is not imaginary money evolved by the banker out of his inner consciousness. Were that the practice bankers might create any number of millions sterling at will and by mere strokes of the pen, and of course such created millions would inflate prices and costs. The art of growing nominally rich would in circumstances like those be as easy as smiling, and strictly there would be no need for banks to have deposits or depositors at all.

But genuine money all the world over stands for value created and work done, and the radical distinction between it and "fiat" money is that the latter stands for nothing save the activity of the official printing press.

When governments wish to draw upon liquid capital —genuine money—the procedure is to issue bonds bearing interest. Liquid capital is transferred to them in payment for the bonds. So far as such borrowings do not exceed available liquid capital they do not cause inflation. Suppose, however, that a government, having exhausted the liquid capital available, wants still more money and a great deal of it. The only resource is to draw on active and passive capital, and this is done by further issues of bonds, paid for, however, by purchasers not out of liquid capital—which presumably has been drained off,—but by pledging their property to the banks for advances upon it. The active and passive capital invested in one form or another is thus translated, to that extent, into liquid capital, and, as liquid, goes to

the borrowing government. It is in that way that a vast public debt may be rapidly piled up. As lenders the public have either parted with their money, or pledged their property for bonds which are mortgages of the national revenues.

Now there is a certain working ratio between the total of liquid capital and the total of legal tender currency. In ordinary circumstances, when production and consumption are balanced, the use of bills and cheques enables a country's business to be carried on with a low legal tender currency ratio. The ratio may not be more than one-tenth of the liquid capital. But where a vast amount of liquid capital is being borrowed and laid out by a government, and at a rapid rate, a great number of eventual retail payments have to be made in legal tender currency, and the working ratio of the latter goes up.

Under such conditions each unit of the legal tender currency commands less in goods and services both because the units are increased in number and because of the altered balance between production and consumption.

An illustration of the method of issuing "fiat" money is afforded by the case of Germany. As the expenditure exceeded revenue, the government, to fill the gap, borrowed from the Reichsbank on the security of Treasury bills, which are simply promissory notes. The bank credited the government with an equal amount of nominal liquid capital, and to meet the government's drawings on this credit, there were handed to the bank newly-printed mark notes, which the bank paid out as required. The accounts of the

bank would thus show on one side a rise in the total of Treasury bills held, and on the other a rise in the total of notes in circulation. With every such increase every existing paper mark as a currency unit became worth less, and the borrowings were, in fact, paid for by successive reductions in the outstanding value of the currency as a whole.

Some economists have spoken of ordinary banking credit and of government borrowing financed by issues of paper money as though they were one and the same, and produced the like effects. But the distinction between the two is radical, and their effects, so far from being alike, are totally opposed. The granting of banking credit for ordinary purposes of industry and trade is the translation of passive into active capital, and as this translation goes to increase production, it has the result, in gradually lowering the cost of products, of making money go farther. Its broad effect, in short, is deflationary. **But public borrowing financed by paper money issues always has the effect of heightening the cost of everything, and of making money not go as far. It is therefore always inflationary.**

There is a like radical distinction between legal tender currency in a precious metal, and legal tender currency in paper. Because money represents value created, and is translatable again into such value, it is of consequence that it should not be counterfeited, for a counterfeit is the passing off as value that which has no value. But a paper legal tender currency can be manufactured **ad libitum,** and its unlimited manufacture is nothing less than counterfeiting

wholesale, and has all the results of a flood of debased coin.

It may be added that the use and circulation of instruments of credit is not inflationary. Not only does their use and circulation expand and contract with the volume of values and commodities dealt with, but they are not legal tender currency. People are not compelled by law to take them. The abuses that have occurred, more especially since the Great War, in the manufacture of "fiat" money, have injured the structure of credit by attacking the security of contract on which the structure is based.

**Much more do the evils of inflation and deflation arise from the risks they import into contract** than in supposed increase of wealth owing to rises in prices or wages, and supposed loss of wealth owing to fall in prices or wages. The gains or losses are nominal not real. For instance, a business concern has a stock-in-trade worth £50,000. Owing to inflation this, let us say, goes up in the terms of the currency to £100,000, and realises that figure. A profit of £50,000 is seemingly made. But as the purchasing power of the currency has changed, to replace the stock sold by another of the like quantity and quality £100,000 must be laid out. In reality, then, there has been no extra gain at all. On the other hand, in the event of deflation, where the purchasing power of the currency is rising, a stock which cost £100,000 may have to be sold for £50,000. Seemingly there is a loss of £50,000. But the £50,000 received will buy an equal stock, because the money now goes twice as far. There is therefore only a nominal loss. Since,

all the same, the inveterate tendency is to confuse nominal changes of value with real changes, these alterations lead to doubt and hesitation, and embarrass enterprise. It is unjust to a creditor to be paid in depreciated money ; and it is unjust to a debtor to have to pay in appreciated money. Inflation causes speculation and gambling ; deflation, unless very gradual, causes stagnation and insolvencies. In either case the common confidence in contract is undermined.

# CHAPTER IX

## COMMERCE AND COMMERCIAL POLICY

Commerce Creates Values by Means of Transport—Increases and Extends the Utility of Commodities—Influence of the Cost and Speed of Transport—And of the Electric Telegraph—Commerce Carried On for Mutual Advantage—Commodities always Tend to Seek the Best Market—Monetary Facilities—The Adjustment of Supply to Demand—Cycles of Trade Prosperity and Depression—The True Preference of Commerce—The Tendency to Seek the Best Market the Origin of All Foreign Trade—Trend of Trade to Become More and More International—Tariffs—The Tariff for Revenue, and the Protective Tariff—Relationship between National and Foreign Trade—Effects of Foreign Trade on Home Prices—And on Earnings and Employment—Tariff Wars—No Difference in Principle between Foreign Trade and Home Trade—Summary of the Economic Influences of Protection—Demand under Protective Conditions never that under Free Exchange Conditions—Cases where Tariffs may be Advisable.

PROBABLY there is nothing in Economics which has remained so obscured by misconceptions as Commerce.

It has been said already that the true motive underlying every exchange of goods and/or services is mutual advantage. But over and above that there

is for commerce, whether national or international, a further motive. **Commerce creates and realises values by means of transport. In that respect there is no difference between national trade and international trade.**

If owing to situation, nature of soil, or other reasons, the raw material of an industry can best be grown in one part of a country, and owing to labour, skill, proximity of coal, or other reasons, the raw material can best be manufactured in another part of the country, the material will have a higher value where it is needed for manufacture than where it is grown. By linking up the want with the supply of the want commerce realises or earns the difference.

It is the same if the raw material can best be grown in one part of the world and manufactured in another. There are few modern countries which could keep up their present level of civilisation were they compelled to depend wholly upon their own products. Commerce opens to them the products of the world at large, and gives them the benefit of every climate. On the other hand, it opens up new markets for their own products.

By this exchange, and more especially as its advantages are always mutual, the world has been immensely enriched.

The service then rendered by the merchant and the merchant adventurer is economically a very real service. His business is to study wants and even to discover and suggest new wants, and how and from where they can best be supplied. He does all this of course for profit, but the profit, apart from its amount, stands for value earned. The notion that merchants

and traders are parasites who somehow contrive to amass fortunes while doing nothing for them, is one of the phantasies of pure ignorance.

Again let us take an illustration—that of the Phœnician merchant adventurers who in old times came to Cornwall for tin. Tin in the advanced countries round the Eastern Mediterranean was a highly valuable material of manufacture. In Cornwall the natives could make little or no use of it; they had not the art. On the other hand, they were glad to get the textiles, cutlery, and other goods brought from the East, and glad to mine and exchange their tin for them. The goods brought, cheap in the East, were in Cornwall precious and rare; the tin, in Cornwall practically useless, was in the East as highly desired in return. The commodities brought, and the commodity taken away were alike **multiplied in value by transport.**

Now transport always adds to exchange value when the effect of transport is thus to add to utility. Exchange value in one place is low because either utility or desirability is there restricted; exchange value in another place is, by comparison, high because there either utility or desirability is extended.

**This constant addition to or extension of utility** is commercially always the reason for movement of commodities, whether from one part of a country to another, or from one country to another.

Needless to say, the extension of utility, reflected in the rise in exchange value, is always, as regards the possibility of realising it, conditioned by the risk, cost and speed of transport. If transport is not safe, or dear, or slow, then by far the greater part of the

value that might otherwise be created by commerce will not be created, and that loss of the extension of utility is an economic loss.

There was a time when it cost more and took longer to move goods from Glasgow to London than it now costs and takes to move them from London to Australia, China, or South America. And it was the same all over Europe. Of course, under such conditions, the movement of commodities was extremely limited. With the making successively of roads, canals, and railways, and the rise in public security, the movement of commodities multiplied enormously. On production and industry that multiplication had corresponding effects. But as trade on land grew in quantity and in variety from these causes, trade by sea increased from the same causes, and gradually piracy was put down as brigandage had been put down. All these were economically great strides forward.

More than anything else, however, the cost of transport both on land and by sea has been reduced by speed, for cost in transport is not a question merely of how many tons of goods can be moved from this place to that, but in what time they can be moved. With greater speed more is earned though the costs per ton are lowered. This has been one of the signal advantages of railways and steamships.

Anything then that reduces the risks and costs of transport brings into the ambit of commerce movements of commodities that otherwise would not occur, and therefore widens and varies the economic extensions of utility. Conversely, anything that adds to the risks and cost of transport, whether directly by

higher charges, or indirectly by delay, tends to exclude movements of commodities from the ambit of commerce since they are no longer profitable enough. **The economic extension of utility is narrowed, and to a corresponding degree production must be curtailed.** On sure, inexpensive, speedy, and unrestricted transport the modern world is vitally dependent.

The world has grown to be the more vitally dependent because of an invention the effect of which, commercially speaking, has been revolutionary—that of the electric telegraph. The telegraph has made it possible with wonderful speed and rapidity to ascertain the differences between the exchange values of commodities all over the world. Very little reflection on the usefulness of such a facility to merchants, enables us to realise the impetus it has given to commerce both national and international. Every civilised country is now covered with a network of wires, plus wireless stations, and the world is linked together by the like means. The truth is that railways, steamships, and telegraphs, plus the discoveries and applications of chemical and electrical science, are the real outstanding features of the New Age.

But these discoveries notwithstanding, commerce, whether national or international, remains, and always will remain essentially the same. It is and always will be carried on for mutual advantage. The alleged trade, national or international, in which sellers make all the profit, and buyers all the loss, or **vice versa,** never existed anywhere and never will exist. It is simply the undiluted moonshine of politicians. Goods

are transported from one place in a country to another because it pays both seller and buyer; goods are exported from one country and imported into another because both exporter and importer make a profit out of the extension of utility which supplies the common motive.

It is because trade rests on these principles that **commodities everywhere and always tend to seek the best market.** It does not matter whether the commodities be foodstuffs, raw materials, or manufactures. On that account trade is the most constant of all the influences that go to enlarge the difference between first cost in production and final price.

There are a variety of factors which make up the relative "bestness" of a market. There is nearness or distance; cost of transport; speed of transport; certainty or uncertainty of sale; and by no means least, the monetary facilities of exchange. A distant market, for instance, may offer so much better monetary facilities, and readiness of sale, as to offset higher transport costs. It is not merely percentage of profit that counts, but rate of turnover. In modern commerce this complex and very specialised **problem of marketing** has been highly developed. It is not, however, even yet so highly developed that miscalculations are not made, and difficulties met with in adjusting supply to demand, and it is much more owing to miscalculations and hitches of adjustment, together with political alarms and disturbances, that the so-called cycles of trade depression occur. They may arise from bad seasons, or a succession of bad seasons

over the world at large, and if so, the effect is universally felt, since agriculture is the basis of human industry. But when traced to their true causes they will be found much more commonly to arise from bad and incompetent government, for bad and incompetent government is unfortunately the rule. Men are very fond of attributing to nature the blame they ought to lay upon themselves.

But as the tendency of commodities to seek the best market is, political obstructions apart, a constant tendency, miscalculations and maladjustments are little by little overcome. Trade, whether home or foreign, always seeks the line of best and quickest profit; smallest risk, and largest turnover. That is the true preference of commerce.

The tendency of commodities to seek the best market is the real origin of every country's foreign trade. To begin with, the trade of every country was first local, and then national. But the search for the best markets does not stop at political boundaries. It oversteps them. The natural and economic tendency of trade therefore, where trade is growing, is to become more and more international. This rise of international trade is the surest sign of rising civilisation.

Such is the main line of economic development and material welfare. Everywhere, however, international commerce has been hampered and opposed.

Commerce and the growth of commerce has always given rise to jealousies and oppositions first as between districts and districts, and next as between province and province. Almost the last thing about it that has been admitted or understood is the mutuality of its

advantages. It is now commonly assumed that the interchange of commodities within the boundaries of every country has always been unfettered. In the Europe of the Middle Ages, however, there were not only national tolls and tariffs, but district and provincial tolls and tariffs everywhere. Every road was obstructed by toll-bars. France before the Revolution was divided into sixteen provinces, each with its tariff, and there was a like state of affairs in Germany, in Italy, and in Spain. The notion everywhere held its ground that these tariffs were necessary to local prosperity.

From the very first trade was loaded by the governments of Europe with imposts. As one of the commonest devices of politics is to disguise exaction as "reform," so imposts upon trade have been vigorously preached up as public benefits.

Tariffs, as is well known, may be either for revenue, or "protective." Where they are set up for the purposes of revenue only, then the larger the trade that can be carried on in spite of them, the better they serve their purpose. But where they are "protective," then the more trade is prohibited by them the better they achieve their declared aim. These two kinds of tariffs are consequently in intention totally opposed.

We may take the case of two countries, one, owing to the extent and fertility of its territory, able to produce an abundance of foodstuffs and raw materials; the other, owing to the character of its population, advanced in the arts and resources of manufacture. In the one instance, apart from foreign trade, food-

stuffs and raw materials will be cheap, and manufactures, by comparison, few and dear; in the other, apart from foreign trade, manufactures will be varied and cheap, but foodstuffs and raw materials dear. If then these two countries exchange their respective products, the people of each find in the other a first-class market, and the impetus will be to exchange.

It is important to notice the economic consequences. In the agricultural country, apart from foreign trade, though the cultivator has to sell his produce at a low price, he has to pay dearly for implements, clothing, and other manufactures he needs in exchange. His nominal earnings, therefore, are narrow, and his real earnings narrower still. This poverty and hardship of the cultivator's lot slows down both the occupation and improvement of agricultural land, and the advance in agricultural methods. Much land will be left to lie waste and fallow, and methods will be backward. Let foreign trade be opened up, however, and there arises a demand for foodstuffs and/or raw materials which at once improves their price. On the other hand, manufactures come in and they are not only more varied, but their cost declines. The cultivator is thus benefited both ways and the result is that more land is taken up and methods are advanced.

Nothing of this is merely fanciful. It is instanced in the history and social circumstances of England during the centuries when the country was changing from one engaged exclusively in agriculture, and with little or no foreign trade, to one with a large and active foreign trade. The change went on until most of the common lands were enclosed. Previously looked

upon as worth nothing, they became valuable exactly in proportion as the methods and real profits of agriculture advanced.

Next turn to the manufacturing country. Apart from foreign trade raw materials are high in cost, since there is only the home supply, and manufactures are, in relation to first cost, low in final price, for there is only the home demand. Again nominal earnings from manufacture are narrow, and real earnings yet narrower, and that state of things goes to depress and limit manufacture, and obstruct the openings for manufacturing skill. But with foreign trade foodstuffs and raw materials fall in cost owing to the foreign supply being added to the home supply, and manufactures rise in price owing to foreign demand being added to the home demand. Here, too, the population have an advantage both ways. They live more cheaply, but trade, giving a wider field for their skill, affords both better profits and higher wages.

This again is instanced in the history of Great Britain during the nineteenth century. Through the growth of foreign trade, while the cost of foodstuffs and raw materials fell to one half, the average rate of wages doubled.

**The economic relationship between home trade and foreign trade is of great importance.** Instead of being, as often imagined, independent and even opposed, the two are absolutely interdependent, and the injury or advantage of one is the injury or advantage of the other. Foreign trade tends at one and the same time to improve the price of staple home products by adding foreign demand to native demand;

and to bring down the price of imported products by adding foreign supply to native supply. In staple industries it widens the margin between first cost and final price.

There is, however, yet another economic consequence. Trade opens up new sources of earnings and employments. More people will be engaged in transport and distribution, and in providing the means of transport and distribution. There are not only the persons engaged on shipping, railways, and harbour and warehouse work, but those employed in building and provisioning ships; in the construction of railways, rolling stock, and road vehicles; in the construction or enlargement of harbours and docks; and in the building of warehouses. And there are the bankers, merchants, agents, clerks and others. All these new sources of earnings are new realisations of wealth, and they have the effect, out of such earnings, of adding a new multitude of consumers whose demand stimulates new production and supply.

But let us suppose that the governments of two countries set up protective tariffs with the object of rendering each as far as possible independent of the other, the declared aim being in the one instance to foster manufactures on the spot, and in the other to foster foodstuffs production on the spot. Trade, even in the face of such prohibitions, does not cease all at once. What happens is that the less profitable parts of trade die away, and these usually are the later developments encouraged by the growth of trade and by the exchange facilities it creates. But the trade done is circumscribed, and reduced to those bare

bones of exchange which, despite tariffs, prove indispensable.

Trade being based on the extensions of utility and enhancements of value realised by exchange, it follows that **the prohibition of trade, as such, can never be an economic benefit,** and that proposition is the less disputable from the fact that the causes which prompt the exchange of commodities between one part of a country and another, are precisely the causes which prompt exchange of commodities between country and country. Just as no district imports produce which can be raised with equal advantage on the spot, nor exports produce which can be sold with equal advantage on the spot, so no country imports what it could just as well do without, nor is able to export what others could do just as well without. Importation is dictated by advantage in buying; exportation by advantage in selling.

Where trade is obstructed those advantages are cut off. There may be political reasons, founded on public security, for ensuring that in certain lines of production a country should be self-dependent. But it is not honest to suggest that that political necessity, or supposed necessity, is an economic benefit. On the contrary, it involves an economic sacrifice.

Economically the effects of a protective tariff are in detail complex, but there are some broad consequences which can be shortly stated.

First, there is a shifting in part of Labour, in part of Capital. The Labour engaged in trade has to seek other means of livelihood, and the Capital embarked in trade, so far as it may not be lost, has equally to

seek other employment. This change is never easy.

Secondly, there is the effect on staple industries, for it is the staple industries of a country which have to pay for the privileges conferred on fostered industries, and not, as usually alleged, "the foreigner."

Take the case of a country whose staple industry is agriculture, but where foreign manufactures are barred out. Of course if equal value for the money could be offered by home manufacturers there would be no need for any import duty, and it follows that for all such goods cultivators have to pay more. **Ex hypothesi** imports of foreign manufactures are cut off, and as in the mass imports are paid for by exports, the foreign demand for the country's foodstuff and other agricultural products is cut off, or at all events greatly cut down. This, since the cultivators had grown accustomed to meeting foreign demand, results in an indisposable surplus, and until agriculture has adjusted itself to the change, the prices of produce fall. Inevitably the profits of agriculture fall with them, and as the cost of manufactures has in the meantime gone up, even the reduced profits of agriculture do not go as far.

The further result of this is that neither Labour nor Capital flows into agriculture as before. Agricultural development is slowed, and a considerable acreage may even go out of cultivation. Meanwhile manufactures have presumably been fostered, and as the percentage of profit in manufacture is kept by the tariff high, Labour and Capital turn to manufacture. But the higher cost of manufactures, joined to the lowered profits of agriculture, restrict demand. The boom in

manufacture is followed by a "slump." The result sought—the fostering of manufactures—has been brought about, but the economic cost of bringing it about is severe. Though very widespread, the belief that demand and consumption under "protective" conditions will remain the same as demand and consumption under free exchange conditions, has no warranty in experience.

Now let us take the case of a country where a protective tariff has been adopted in order to foster the home production of foodstuffs, and where the staple industries are manufactures. Here again, foreign supplies of foodstuffs being presumably cut off, the demand abroad for the country's manufactures will be cut off to the same extent, since the purchases of foodstuffs abroad created a demand for manufactures abroad. Until manufacture has adjusted itself to that loss of demand, there is an indisposable surplus, and the prices of manufactures go down with a run. There is, therefore, both a rise in the cost of living, a falling off in employment, and a downward movement alike in profits and in wages. Manufacturing development is slowed or arrested, and not a few works and businesses may become insolvent and close down. Meanwhile, presumably the growing of foodstuffs has been fostered. The lower wages and profits of manufacture, however, soon squeeze down the consumption of foodstuffs, alike in variety and quantity, to a minimum. Here, also, the belief that demand under free exchange conditions must be the demand under "protective" conditions turns out fallacious.

What has been said illustrates the consequences

of a "tariff war." There has been an increasing disposition to impose checks upon international trade, that reaction being the result of a very widely-spread alarm. But though the struggle to achieve free international exchange may be a long one, the purely economic influences which make for free exchange are at once so strong and so constant in their operation, that political obstructions are certain, one by one, to weaken and disappear.

# CHAPTER X

## THEORIES OF TRADE

Opposition to Free Exchange—The Mercantile Theory—Why Discredited—Freedom of Exchange Not a Theory—The Balance of Trade—Visible and Invisible Exports—The Equilibrium of Commerce—International Exchanges of Goods and Services—Illustrations—The Trade Balances of Great Britain, U.S.A., and India—Payment of External National Debts—Settlements of Balances—The Gold Standard—Bi-metallism—Rates of Exchange—Movements of Gold and their Influence on Exchange Rates—The Arbitrage Points—Commercial Utility of Gold Movements.

IN the world's history so far commerce has never been carried on under conditions of free exchange save to a very limited extent, and for limited periods. The rule has always been imposition of tariffs for revenue. Out of these rose the doctrine of protective tariffs.

The first form of the doctrine was the once famous **Mercantile Theory,** which still has adherents. According to that theory a country grows rich not by exchanging its products for foreign products at an economic advantage, but by parting with its products for silver and gold. The more a country can accumulate of the precious metals, the wealthier, according to the theory, it becomes. In the seventeenth century the government of France acted upon that theory.

France was then a great exporter of corn, and the corn was exported as far as possible for bullion, other products being, under protective legislation, barred out. The result was that while the money largely went into hoards, the country was subject to famine whenever the harvest fell short, and the French peasantry became scarecrows clothed in rags. It was forgotten that the use of money is that of a medium.

In contrast with this was the policy adopted by Great Britain about the middle of the nineteenth century when the Mercantile Theory had been discredited by the writings of Adam Smith, and when it came to be realised that a country which exports actual wealth, and gets nothing in return but a medium, will, unless the medium be used to obtain or create equivalent wealth, be in fact impoverished. Great Britain retained only a limited tariff strictly for revenue. The adoption of free exchange was in truth a policy of relying for political security not upon acts of parliament, but upon the country's navy and the valour of British seamen. It was a policy, in effect, of trusting to the sea and to command of the sea, and its outcome was both the rapid growth and settlement of the British Colonies, and an advance in wealth that has never in the same space of time been equalled in the history of nations.

**Free trade**, or freedom of exchange, has often been spoken of as a theory opposed to other theories. But it is not a theory at all. It is simply a practice. The theories are those reasonings advanced in support of restriction of trade.

Out of the Mercantile Theory, when it was challenged, rose another—that of **the Balance of Trade**, and this

newer theory, or illation, asserted that if imports are in value greater than exports, the balance of trade is against a country ; if, on the contrary, exports are the greater in value, the balance is in favour of a country. There is a certain truth in the statement. At the same time the conclusion that excess of exports made up by receipt of the balance in money enriches, and excess of imports made up by payment of the balance in money impoverishes, is entirely wrong. The conclusion, indeed, is only the old Mercantile Theory in another form. So far as actual wealth goes the conclusion turns the truth right round. Excess of visible exports is impoverishment ; excess of visible imports is enrichment.

Doubt began to be cast upon the Balance of Trade hypothesis when it was seen that Great Britain, which had a greater excess of visible imports than any country in the world, instead of growing poorer, and being drained, as asserted, of gold to pay for them, was growing richer, and that the excess of imports grew as the trade and wealth of the country advanced. There was plainly something wrong with reasoning which failed so badly to square with the facts.

Economists, therefore, began to look into the question, and they were not long in finding out that there are invisible exports as well as visible. Just as exchange in national life is that of goods and/or services for goods and/or services, so exchange in international life and business is exactly the same thing, and one more blow was given to the belief that foreign trade is something quite different and peculiar.

The outcome of these researches was the still newer

theory of the **Equilibrium of Commerce.** It takes into account both visible and invisible imports and exports, and covers the exchange of services as well as the exchange of goods. As applied to British trade it may thus be set out :—

| Imports. | | Exports. | |
|---|---|---|---|
| Foodstuffs, raw materials, manufactures, etc. . . | £*xyz* | Manufactures, etc. (visible) . . . | £*xy* |
| | | Earnings of shipping; return on foreign loans and investments; banking and insurance profits (invisible) . . | £*z* |
| Total. . . . . | *xyz* | | *xyz* |

The "invisible exports" are services rendered, and it is found that they make up, year by year, the exact excess of visible imports over visible exports. It follows that the more Great Britain earned through her shipping, the larger the loans and investments abroad and the return upon them; and the greater the services rendered to international trade as bankers and insurers, the larger were the receipts in the form of actual and useable wealth.

Naturally the Equilibrium of Commerce varies in the case of different countries. The U.S.A., for example, has as yet no large total of invisible exports, and as the policy adopted restricts the importation of many foreign commodities, payment for exports has largely to be taken in bullion, while for a considerable

total of exports payment has, for the present, been suspended; the goods in fact have been sent abroad on credit. In the case of the United States the Equilibrium would stand :—

| Exports. | | Imports. | |
|---|---|---|---|
| Foodstuffs, raw materials, manufactures . . . | $\$xyz$ | Goods . . . . . | $\$x$ |
| | | Gold Bullion . . . | $\$y$ |
| | | Balance (credit given) | $\$z$ |
| Total . . . . | $xyz$ | | $xyz$ |

In the case of France for some time after the Great War the imports largely exceeded the exports, but the excess consisted of the goods sent (chiefly from the U.S.A. and Great Britain) on credit. They were, in fact, loans to the French government translated into commodities. In the case of Italy a part of the national income, estimated at 1,000,000,000 lire a year, is made up of sums remitted by Italian emigrants to relatives at home, and money laid out by foreign visitors to Italy. These receipts create a demand for commodities reflected in imports, which are by such means paid for. Another case of interest is that of India owing to the demand for gold, and remittances to England out of the salaries and earnings of Anglo-Indians. The account may thus be given :—

| Exports. | | Imports. | |
|---|---|---|---|
| Foodstuffs, raw materials . | R's $xyz$ | Manufactures, equipment, plant, etc. | R's $xy$ |
| | | Gold ; remittances | R's $z$ |
| Total . . . | $xyz$ | | $xyz$ |

The remittances, representing services rendered, are paid for in exports of commodities.

Into the Equilibrium of Commerce also enter the receipt of the process of public borrowings and payments abroad of interest on public debts. These latter payments take the form of merchandise for the reason that they are discharged in bills of exchange which, as stated, are the international medium. The bills of exchange represent payments due for goods exported. Exporters, when the bills accepted by foreign importers come to hand, pay them into the banks, and receive cash for them. The government buys up the bills from the banks out of public revenue. Thus the Russian government before the War paid the interest on its external debt in bills of exchange representing wheat; in effect it paid in wheat. The bills for the wheat formed a foreign credit in favour of the Russian government and out of that credit liabilities on interest coupons were discharged.

Facts like these serve to explain why a debtor country has an excess of visible exports over visible imports. So far as exports sent out are offset against liabilities discharged, nothing comes in in place of them. The actual exporters of the goods, and the individual foreign creditors alike receive their money, but in fact the persons who pay, and in commodities, are the taxpayers of the debtor country.

It will be seen that the so-called Balance of Trade relating to goods only and not to services and debts, is a statement at best of only part of the truth. The theory of the Equilibrium of Commerce tries to cover the whole truth.

In connection with the Equilibrium of Commerce it should be noted that the legal tender currency of one country is, as currency, of no value to another. Hence so far as imports of goods are not balanced by exports of goods, the difference has to be in some form recognised as value internationally. For example, payment for services rendered would be useless if made in foreign legal tender currencies as such. It has either to take the form of commodities useful and saleable in the country receiving payment, or else, if there are no such commodities or not enough of them, or their importation is prohibited, it must take the form of precious metal. In the case of Great Britain, payments for services rendered have almost wholly taken the form of foodstuffs or raw materials, since these are useful and saleable, and only a very slight balance would in ordinary times come in in the form of gold. There is an exception in the output of gold mines, for that output is a commodity of commerce like any other, and not a movement of gold for the purpose of adjusting exchange. But in the case of the United States where there are very extensive prohibitions of imports, a very considerable balance has had to be imported in the form of gold. It is the tariff policy of the United States which explains the flow of gold to that country since it became a creditor State.

The point is that, internationally, the metallic legal tender currency of a country is estimated and accepted as bullion, that is, according to its actual content of fine or pure gold, or silver, as the case may be. Thus the Indian rupee is a silver coin of the size and weight

of an English half-crown; but outside India the legal tender value given it by law and custom in India does not count. It is then merely so much silver, and its value rises and falls as the price of silver rises and falls.

The reason for all this is plain enough. The law of a country may give a coin any nominal value the legislature chooses, but the law of a country only applies to that country. In international dealings, therefore, when it is a question of paying balances in precious metals, such balances can only be received at their real, or bullion, value. Otherwise creditors abroad might be put off with merely nominal payments.

This helps us to understand the adoption in international dealings of the **Gold Standard,** and the question of **Rates of Exchange.**

In the estimation of balances due between country and country in their periodical settlements through their respective banks, the criterion adopted is fine gold as bullion, and the value of gold itself is measured by the sterling price per fine ounce. **Actually the Gold Standard is Troy weight.** In every ounce Troy there are 20 pennyweights of 24 grains each, or 480 grains, and as the British sovereign contains 123.27 grains of fine gold, it is easy enough to see that 480 divided by 123.27 gives the sterling price in sovereigns; that is, £3 17*s.* 10*d.* per ounce.

Gold, in accordance with its sterling measurement in sovereigns, is thus the basis for the settlement of international balances. There has to be some sure and universally accepted basis, or otherwise balances could not be arrived at, or one currency translated, for purposes of exchange, into another.

Now what in fact are exchange rates? **They are the day to day estimated values of currencies in terms of gold.**

When such currencies were actually metallic media it was not difficult to arrive at their respective values in terms of gold, for the fine gold content of the standard unit of each currency readily enough determines the relationship. But when the legal tender currencies of most countries in Europe ceased to be metallic media, and became inconvertible paper media, then their basis ceased to be their gold content, and became that of each country's national credit. These credits not only varied greatly, but fluctuated and of course the international exchange rates of their currencies fluctuated to correspond. There was no longer the same universal and steady foundation. **The problem of stabilising exchange rates is in substance the problem of stabilising national credits—if that can be done.**

There is, of course, the second precious metal, silver, still universally used as the money of Asia. When a balance has to be settled, say, with China, and is in favour of China, then it is silver that is in demand, and as China is the most populous State in the world with a great trade, the price of silver goes up. If, however, the balance is against China, the price of silver falls. Unfortunately these fluctuations have the result of affecting the international value of the rupee, and a fall in the price of silver, which turns the balance against India, means more in the form of commodity exports.

To check the fluctuation of silver in terms of gold,

it has been proposed to declare internationally that silver shall also have a standard or mint price of, say, 4*s*. 2*d*. per fine ounce, or alternatively 16½ ounces to one of gold. That proposed double standard is the **theory of Bi-metallism,** and it has some ardent advocates. Nor need it be disputed that, were the price of silver in relation to gold constant, it would, in dealings with Asiatic countries, be of enormous commercial advantage.

On the other hand, if adopted, the double standard would involve the option of offering silver in place of gold at the price fixed upon, and under what is known as **Gresham's Law,** this standardisation of silver would tend to its preference for the purpose ; that is, it would, by degrees, drive gold out of use as a medium and into hoards. Gresham's Law lays down, and experience has proved its truth, that an inferior currency drives a superior currency out of circulation if both be in circulation together. That is the objection, and in view of the immense utility of the Gold Standard in the world's dealings, the objection is a very serious one.

Possibly the difficulty might be got over by adopting, say in India, a rupee coinage of gold alloyed with silver in a determinate ratio, and it may be, though such a development is far off, that the future standard coinage of the world may be a gold-silver alloy. In the natural state gold and silver are mostly found together as an alloyed ore. But the question is one that needs to be carefully explored. Certainly the world's standard metallic coinage might by such an expedient be very greatly enlarged.

Now what is the part which since the adoption of the Gold Standard the more precious metal has come, in international dealings, to play ?

It has been explained how, by means of the Gold Standard, balances, whether receivable or payable, were calculated in various national currencies. They were arrived at by taking on one side and on the other the total of instruments of credit whether covering merchandise, bullion dealings, private remittances of money, or public debt payments. If there was a balance against country *A* due to country *B*, then the rate of exchange—the terms on which bankers in *B* would translate *A* currency into *B* currency—would move against *A*. In other words, the value of *A* currency in terms of *B* currency would go down and the fall would depend on the size of the balance against *A* and on the chances of its speedy liquidation.

There was a fall because the risk of credit transactions with *A* was on the whole increased, and the difference in the exchange rate was really an intimation of the risk; in fact, a kind of insurance premium charged to cover it. Internationally the credit of *A* for the time declined.

The effect of such a decline was to check trade for the time being. But there was a further effect. Gold in country *A* would advance to a premium above its standard price or parity. Dealers in gold, therefore, in moving it from *B* to *A* could realise that premium and make a profit. The premium arose owing to the call for gold to support and assure credit in *A*, for with an increase of the gold at the disposal of the banks, they could lend more freely, and by lending

than is wanted, price falls, and Supply is "stepped down." And to many people that statement seems a truth too plain to be contested.

Unfortunately the generalisation just given is at best only part of the truth, and being only half-a-truth, if so much, is misleading. As misleading it has been a fertile source of losses and mistakes.

A larger view of the truth is that the relation of Supply to Demand and of Demand to Supply depends not on quantity only, but on quality.

Let anybody consult his own experience. He will not be long in seeing that in everything he buys or sells, and indeed in all the activities of human life, quality, which includes variety and adaptability, plays as great a part as quantity, if not more so. For quality, which also includes fitness and design, enters into Labour, as well as into the results of Labour, all the world over. Indeed, it enters into those results the more as civilisation rises, and **the part played by quality is a part of growing importance.**

There is a school of Economists who are great on graphs, charts, and tables of statistics, and in their way, as evidences, these things are useful enough. But when they are taken simply by themselves, the conclusions that can be drawn from them are, after all, limited. If the element of quality be ignored, the chances are that the conclusions arrived at will be wrong.

It has been pointed out that human wants are not fixed and stereotyped. Nor is there any known influence in the world that will ever make them so. We may candidly rejoice in the fact.

That being the case, to arrive at the working relationship between quantity and quality is easy enough. The relationship is that **where quantity is sufficient, preference, or demand for quality, arises ; where quantity is insufficient, preference, or demand for quality, is narrowed and declines.**

This working relationship is in all exchange, whether of goods or of services, of great economic importance.

It is not the fact, therefore, that where the supply of a commodity exceeds demand in point of quantity, the only effect is to lower the price, and thus restrict supply. The effect on price is purely temporary, and the more lasting effect is to change and raise the quality of the supply and vary it. The demand becomes different, and supply accommodates itself to the difference, and the result is that in point of value what may be lost in quantity is gained in quality.

This may be confirmed from experience in any branch of commerce. Take such a commodity as tea. If the supply in quantity is rather above demand, the better grades find the readiest market, and the poorer grades are neglected. And if there is, on the average season by season, a margin of supply over demand, however small, there will be care in grading, and a desire, in order to command a readier market, to cultivate the better grades. Lower grades will cease to be grown or packed. In short, the average of quality will rise, and, as said, what is lost in point of quantity will be gained in point of quality. It is the same with cotton, or wheat, or rubber, or any other product. Sufficiency of supply in quantity always leads to improvement in quality and grading.

On the other hand, and conversely, if for any reason, natural or artificial, quantity becomes insufficient, then demand, for the time, will put up with a lower quality. **There will always be found a falling off in quality where insufficiency or scarcity occurs.**

Once more this is readily enough confirmed from experience. Where in any season there is not enough of any staple product to go round, even the lowest and worst grades find a fairly ready market; and if production from any cause, such as war for example, or a succession of bad seasons, were for any length of time to fall short, even the lowest and poorest grades would be freely grown, and care in grading would fall off. There is hardly a food product or raw material product that could be named that is not subject to these influences. Nothing, then, is economically gained by naturally or artificially restricted production. All that happens is that the rise in quality is arrested, and that is an economic loss.

In all these respects there is no difference whatever between national and international trade.

The considerations just stated indicate the true Law of Supply and Demand. **The true Law is that the influence of Supply and Demand one upon the other is reciprocal and equal.**

It is vital to any sane and clear view of Economics that that truth should be laid hold of with both hands.

In illustration of it we may again appeal to common experience. The miles and miles of shop fronts and stock displays in London or any other great centre of exchange, what are they there for? They are there because they stand for Supply educating and

stimulating Demand by reminding of wants, or suggesting new wants. The theory has been that Demand educates and stimulates itself. It does not.

The theory has been that if Demand did not already exist, Supply would not be there. The theory is all wrong.

Every new improvement in Supply, whether of foodstuffs, or the preparation of foodstuffs; clothing stuffs and modes; new conveniences for houses; new machinery, processes and applications of machinery; or new savings of power, to the extent that it is useful and desirable, creates its own demand. It must do, for obviously the demand did not exist before. When the first primitive genius invented the bow and arrow, a desire, not known before, arose to possess bows and arrows. It was the same with the plough, the spade and the hammer; the same with the lever, the wheel, the pulley, and the screw, and their uses; it is the same now down to the very latest thing brought out. Before Tyndall discovered the electric light nobody demanded electric light, but there is now a world-wide demand for it, and vast industries are dependent on the demand. Demand governing Supply? If that had been the fact, mankind would have stuck in the mud for evermore.

Observe, none the less, that the truth is **not** that Supply governs Demand. The truth is that their influence is reciprocal and equal.

**There are always what may be called latent or potential wants ready to become actual at a touch of the wand of discovery, and production.** And the successful men, the makers of fortunes, are

those who know and act upon this economic truth; the men who understand the elasticity of demand, and its capacity for variation. These are the men who know how to wield the wand. To the elasticity and variety of demand there is no assignable limit.

Primary wants are satisfied first. When, however, they are satisfied, and to the extent that they are met, the ascent in quality and variety begins. For instance, men, when agriculture is rude, are content to eat rye bread. But when agriculture advances they want wheaten bread. There was a time when wheaten bread was a luxury. It is now a common foodstuff. There was a time when shirts were luxuries. They are now worn by the poorest. There was a time when bed linen was a luxury. It is now found in every household. On these as on other economic truths, the tendency is to take too short and localised views. Economic and social truth is not unlike a picture painted on a big scale. To bring its parts into focus we have to stand off it, and look at it with detachment.

**The influence of Demand upon Supply is therefore the threefold influence of quantity, quality, and variety. And the influence of Supply upon Demand is the same.**

Out of the idea that Demand governs Supply, the complementary fact that Supply equally governs Demand being left out of account, have sprung alike in national and in international trade, the efforts to get-rich-quick by some form of monopoly. To corner and cut down Supply is assumed to be the easy and rapid road to riches. It is always, in such projects,

taken for granted, that Demand as it presently is will be just the same under the changed conditions.

But such expectations and projects never, as monopolies, meet with more than a transient success.

Demand being elastic and squeezable as well as expansible—for it would not be expansible if it were not squeezable—the attempt by means of monopoly, or limitation of supply, to get something for nothing by forcing the consumer to take a less quantity or a lower quality for the same price, or at a higher price, always comes up against not only the lessening of Demand, but **the variation of Demand.** In the long run the consumer invariably gets back upon the monopolist not merely by reducing his demand, but by directing it into another channel. Monopoly and curtailment always stimulate variation.

This is the weak point with all the Trusts, Cartels, and rings of middlemen. Direct competition they may be able to crush out; indirect competition baffles them. To deal with indirect competition, which, so far as they are monopolistic, they themselves encourage, they have to spread more and more, and take in more and more allied concerns. But in doing so they risk breakdown from sheer complication, weight, and extravagant capitalisation. A combine which by monopoly makes the use of a product dear, simply encourages the search for and the employment of substitutes.

In this respect Cartels, which are associations of self-governing concerns bound together, as in France and Germany, by certain common rules, incur less risk than elaborately interlocked Trusts. The form devel-

oped in the U.S.A. and in Great Britain is that of some great limited liability corporation holding all or most of the shares in a number of subordinate and controlled companies.

But in the light of experience, having from experience found out the weak point and delusive effect of monopoly, Trusts have been tending to amend their practice. In so far as they can facilitate collection and steady the supply of raw materials, level up and improve productive processes, command a readier exchange, and cheapen distribution, they have a strong side, and it is that side which, in the most notable modern instances, has developed. The United States Steel Trust is an example. But there are many others, all more or less copies of its methods. In such enterprise there is prosperity and profit, and the " trustification " of industry on these lines is likely enough to become yet more pronounced. In proportion, however, as it does, mere restriction based upon monopoly, and the effort to arrest progress in quality and variety must be recognised as a failure, involving in the long run nothing but loss.

Notwithstanding, however, the teachings alike of reason and of experience, the belief in monopoly as a royal road to riches dies hard. The simple truths that Supply influences Demand as much as Demand influences Supply, and that Demand is elastic and variable, though ignored or overlooked, always make themselves felt. It does not alter the weight of a stone in the least to deny that it has weight. So it makes no difference to economic truth to fly in the face of it. Monopoly is shortsighted because it fails

to see that there are many ways of meeting any common human want. It is the very converse of true enterprise, for its motives are at once greed and fear, while true enterprise is open-minded and courageous. None the less, in every age the spirit of monopoly has been a very active factor in human affairs. The present age is in that respect no worse than any other, nor is the spirit of monopoly confined to any one class. It is one of the greatest obstacles to economic advancement, and has led to more national jealousies and wars, and more class bitterness than any other cause that could be named. It has also brought about more losses than any other cause. Nearly all economically bad legislation may be traced to it.

While freedom of exchange, as consistent with the true economic law of Supply and Demand, ensures full equality of opportunity, the very essence of monopoly is to render opportunity as far as possible unequal.

And as that is its essence, Cartels and Trusts, so far as they are monopolistic, are opposed to free exchange, and inconsistent with free exchange as a policy in international trade.

The question is here involved of competition as against combination, and very widely efforts are made to narrow the scope of competition, and widen that of combination.

It has been shown that there is a social interdependence which enters into every relationship of life, and most of all of civilised life, and it remains none the less a fact, though it may be denied or overlooked alike by those theorists who call themselves extreme Indi-

vidualists, and by those whose ideal is the management of everything by and through a government and government employees.

Unfortunately the assumption underlying these theories, is that competition is governed and determined by quantity only. They rest upon the belief that, if production be adjusted to consumption in point of quantity, there will be a perfect social balance.

When, however, the influence and effect of quality is taken into account alike as regards goods and services, it is readily seen that competition and combination are double-edged. Competition is most of all a reliance on quality, and where equality of opportunity in production is left free, it is the best quality that commands preference. But the resultant steady, though gradual, rise in quality, educates and broadens demand, and that reacts upon quantity. On the other hand, where there is combination to restrict the offer of quality against quality, that also reacts upon Demand and therefore upon quantity.

Whether as a producer or as a consumer no man is in any civilised society an isolated unit, but a unit in a complex and naturally organic system, and it is merely doctrinaire and arbitrary to set up theoretical limits to combination and association. Equally arbitrary and doctrinaire, however, is it to insist that combination must be carried to the point of ruling out free choice and initiative. There is a true Socialism and a false Socialism, and not less a true Individualism and a false. The true forms of both are, as said, complementary not opposed.

Economically speaking, everything depends on the aims a combination is intended to achieve. If its aims are to facilitate exchange whether of goods or of services, then to the degree that it does so, it must facilitate production at the same time. But if its aims are to restrict exchange, then equally and inevitably production will be restricted. Complex and varied as production has come to be, exchange is even more difficult and delicate. The reciprocal influence of Supply and Demand one upon the other is the very gist of economic welfare.

Owing to the elasticity and variableness of Demand, **a Cartel or a Trust** formed merely to set up monopoly conditions in any great national industry in order to obtain a higher price from consumers and users, at once makes the national market for its products either for imports of the like commodities or for commodities that can be used in place of them more attractive. Under a policy of free international exchange, therefore, merely monopolistic Cartels and Trusts are out of the question, and if Cartels and Trusts are formed, they have to keep to the business of improving production and facilitating exchange. Otherwise, to offset the economic effects of mere restriction, it becomes necessary nationally to extend in order to cover substitutes, and internationally to impose checks upon importation. The monopolistic conditions set up have, in short, to be safeguarded.

Invariably, however, privileges conceded to one set of monopolisers, arouse insistence on like privileges from other would-be monopolisers. Thus restriction tends to spread from industry to industry, and to

include more and more commodities, or possible substitutes.

But Demand is then rather constrained than educated and encouraged, and impetus towards higher quality and greater variety weakened. For these reasons, though for a time there may be a higher percentage of profit, the **total** of profit tends to fall, because the total of production tends to fall. Demand as far as possible goes into other channels.

The plea almost always advanced in favour of monopolistic conditions is that they foster production, and by assuring profits, mean steadier employment and higher wages. The plea, however, has not been proved by experience to be well founded. No sound economic development needs special and artificial safeguards.

In the case of privileged industries, the common experience has been that there is not only an adverse effect on Demand, but an adverse effect on Supply. There is not the same care as to methods and costs of production. Methods tend to fall behind and costs to become wasteful.

Monopolistic combines also tend to stereotype production and cramp its adaptability.

The reason why quality falls when there is a rise in cost to the consumer is found in the reaction on Demand. If price be raised by restrictive combination Demand falls off. To keep up demand a lower quality is brought out at the old price. The only thing, however, which really encourages and expands demand is good and improving value for the money. Since merely monopolistic combination is based upon

offering less value for the money, the belief that the less value offered will not affect demand is fallacious.

It is supposed to be a practice on the part of Cartels and Trusts, where a limit has been laid down to production in order to keep up the price and rate of profit, to sell any surplus stocks for export only, and to sell at less than cost price. In that way the profit on sales at home is made, it is asserted, to cover the loss on surplus sent abroad. Surplus stocks left on the hands of Cartels and Trusts have been a common enough experience, and whether they arise from shrinkage or variation of demand or not, does not here affect the argument. Sale for export at less than cost price is known as "**dumping,**" and the contention is that by **the practice of "dumping,"** Cartels and Trusts may, of set purpose, apply part of the profit made at home to capture markets for their products abroad by underselling, and by attack planned deliberately to wreck a foreign competitive industry.

On those assertions it has first of all to be observed that such "dumping" is not practicable on any scale worth talking about apart from restraint of a trade by combination, and monopolistic Cartels and Trusts are, in turn, not practicable apart from legislation in restraint of trade.

Secondly, so far as goods are sold for export below cost, a present of value is made to foreign purchasers and consumers, and at the expense in effect of home purchasers and consumers. For a Cartel or Trust to enter upon a policy of this kind, and keep it up, a very large outlay would be involved, and that outlay would be speculative.

But is the speculation worth while? According to the contention most in favour with those who raise the outcry against "dumping," when a foreign competitive industry has been wrecked by underselling, the cost of the imported goods will be put up, and the dumpers will then refund themselves. It has to be noted, however, that in order to wreck a competitive industry abroad not only would the "dumping" have to be extensive and consequently expensive to the dumpers, but that if the price were put up the foreign competitive industry would at once revive. A heavy present cost might be justified by an assured future advantage, but a heavy present cost for a very unassured future advantage suggests recklessness rather than foresight. As a fact, very little proof has been forthcoming that "dumping" has anywhere been adopted as a line of action on any scale worth considering.

Nevertheless, the outcry against "dumping" has led to a good deal of anti-dumping legislation.

The principle running through that legislation is that no goods from abroad shall be allowed in if their cost of production is less than the cost of production in the importing country. In the estimated costs of production transport charges are not included.

Now no goods are ever imported from one country into another unless, as already shown, their value is added to by transport. Trade is not carried on for the mere fun of the thing. The motive is profit, and underlying the profit is expanded utility. If, then, it is enacted that there can be no foreign trade unless costs of production abroad are equal to those at home,

the very condition on which all foreign trade rests is negatived, for if the costs abroad are as high no profit can be made on the movement. Trade is the movement of goods from where they are worth less to where they are worth more.

But what is meant by production costs ? To arrive at a real meaning not only must quantity be compared with quantity, but quality with quality. On such a comparison it is always found that **the lowest production costs are those of the most efficient industries.** Quantity for quantity, and quality for quality, cotton fabrics are produced in Lancashire at a lower cost than anywhere in the world. And that is why they are in demand over a great part of the world. Again, many chemicals and dyestuffs are, quantity for quantity and quality for quality, produced in Germany at a lower cost than anywhere in the world. It is not to be supposed that this lower cost in the one instance and the other is the result simply of ill-paid and sweated labour. On the contrary, it is the result of science, experience, organisation and skill, and it would be impossible unless the best labour of the kind were available for the purpose. If efficiency in industry did not result in lower production costs, quantity and quality being taken into account, efficiency would have no point or value. The result is that so-called anti-dumping legislation imposes a penalty at once on industrial efficiency, and on economic advantage.

Not a little legislation has been passed in restraint of trade because the true course and character of trade has not been understood. It has been commonly

supposed that if one country sells exports to another, it must buy an equal total of imports from that other. But owing to the facilities afforded by banking and exchange, international trade in the modern world is subject to no such limitation. Exports from country *A* to country *B* may not be paid for by exports from *B* to *A*. They may be paid for by exports from *B* to *C*, *D* or *E*, because *A* prefers to take the productions of *C*, *D* or *E*. International trade flows rather in great circular currents, and deliberate obstructions apart, tends so to flow more and more.

A current of the kind may thus be illustrated. Before the Great War Russia exported agricultural produce to Germany. With bills due for that produce Russia bought tea from China; with the same credits China took imports from India. In turn India took imports from Great Britain. Further, with the payment for these exports to India, Great Britain in part settled for foodstuffs or raw materials from the United States; the United States with the proceeds took produce from Brazil; on United States payments Brazil took imports from Germany; and Germany, with the payments from Brazil, took imports from Great Britain.

All this arose from the balancing of bills payable against bills receivable. Individual importers or exporters had nothing to do with that process. They bought or sold everywhere according to their estimates of the needs of markets and the prospects of profits, and bought and sold for payments translated into their respective national currencies. But behind their transactions was the balancing organisation of world

exchange carried on through the banks and accepting houses, and dealers in bills.

It will be seen then how very serious a matter for commerce it is to obstruct its flow and to vitiate the operations of exchange by rendering currencies of uncertain value. The economic evils of the world are the consequences of its political evils. Nothing is so common as for men to lay at the door of the economic system the shortcomings which are really their own. The imperfections of the economic system and of society are the imperfections of men themselves.

The points brought out by the illustration given are (1) **that commodities always seek the best, which also means the readiest and most suitable market,** (2) **that trade in the world sense becomes more and more interdependent as the freedom and facility of exchange increase,** (3) **that any interruption of its flow at any one point reacts all along the line.**

This truth has been obscured under a multitude of transactions, but on a broad view its outlines stand out clearly enough.

# CHAPTER XII

## PRICES

The Influences that Govern Prices and Wages Fundamentally the Same—Five Elements of Price—All Prices Governed by Three Conditions, Plus Risk—Effects of Quantity on Price Movements—World Prices and Forward Contracts—Grading of Commodities—Quality and Adaptability—Choiceness—Rarity—Changes in the Value of Gold—Their Causes and Consequences—The Theory of Gustav Cassel—Why Other Commodities are Priced in Terms of Gold and not Vice Versa—Slow Movement of Gold Value Changes—Influence of Gold Output on Prices—Counter-influence of Production and Transport—The Basis of Exchange Reckonings—Parity—Key to the Exchange Puzzle—A Gold Basis of Currency Steadies Prices—Paper Currencies Aggravate Price Fluctuations—Purchasing Power Parity.

TRANSLATED into terms of money, Supply and Demand give us prices and wages. We have been considering Supply and Demand under general aspects in terms of quantity and quality. In common life, however, they are dealt with in terms of money. In common life the reasoning is from consequence to cause.

Prices and Wages are linked together because while the prices of goods are in fact the prices of services,

wages also are the price of services. **The influences, therefore, that govern prices and wages are fundamentally the same.**

Bearing the link between the two in mind, it will be seen that the true rise in the value of services is a rise in the terms of what they can command in the form of commodities and conveniences. If any given service comes to command twice as much in goods or conveniences, its value is clearly enough twice as high as before. And that in turn depends, also clearly enough, on the speed and skill of production.

There are two ways in which rise in the value of services may make itself evident. Either in terms of money the price of services may go up to double, the money costs of commodities remaining as before; or the money costs of commodities may fall to one half, the money rate of wages remaining as before. The first of these evidences of such a change is a rise in **nominal** wages; the second a rise in **real** wages. Plainly they amount to exactly the same thing.

Because they amount to exactly the same thing what always happens when the values of services, owing to advancement and improvement of production and exchange, are going up, is that **there is an upward movement in nominal wages accompanied by a fall in prices.** In has been supposed that nominal wages ought to go up when prices go up, and come down when prices come down. But there is no scientific or economical principle at the base of such a rule of adjustment. The fundamental economic fact is rise in the value of services owing to improvement of production, or fall in the value of services

owing to decline in production. Since the value of services can only be measured in their results, it should be manifest enough that as results, from any cause become less, the value of services becomes less.

Let us suppose that there is such a decline in production that prices in consequence of it go up to double. That of course would mean that real wages would go down by one half, because the value of services measured in results would have gone down by one half. Now suppose that to meet this fall the nominal rate of wages is doubled. What happens? Prices, which before were doubled, are now quadrupled, for the higher nominal rate of wages has to go on to prices. Otherwise it could not be paid. The fall in real wages is not changed because the fundamental economic fact that services have gone down in value is not changed.

This has been called **the "vicious circle" of prices and wages,** and it would be quite possible, by ignoring the economic basis of the matter, to force up nominal wages to any figure. Prices, however, would mount in the same ratio. The only cure is increase and improvement of production. Where marked enough, **increase and improvement of production raises nominal wages and lowers prices at the same time, while decrease and decline of production tends to lower nominal wages and to raise prices at the same time.** There is no known method by which men in the mass anywhere or at any time can get something for nothing.

It is important to note that good and efficient production raises the value of services and that bad and inefficient production lowers the value of services,

because there is a very prevalent belief that bad and inefficient production results in benefit, and a belief just as prevalent that good and efficient production leads to loss through the lowering of prices. Good and efficient production is feared because it would lead to a glut of goods, and consequently to unemployment. These beliefs, as will be shown, are alike baseless.

Several **elements** enter into **price** whether of goods or of services. These are (1) quantity—relative abundance or scarcity; (2) quality; (3) fitness or adaptableness; (4) choiceness, and (5) rarity—scarcity in relation to demand that is absolute or abiding as opposed to the scarcity that is temporary or comparative only.

**Each of these factors** of price is, however, itself **conditioned** by production cost; by facility of exchange or the reverse; and by difficulty or otherwise of distribution. Finally, in every instance price is affected by the greater or less presence of **risk.**

All this makes any calculation of price really a complex matter, but almost universally usage, custom, and precedent come into play. The price structure, as it were, has been gradually built up, and any serious disturbance of it, much more violent and widespread fluctuations, are both socially and economically grave, and, as a very slight consideration goes to show, are bound to react adversely alike on exchange and on production.

This is one aspect of the mischief of currency changes. They give rise to uncertainty, and, in regard to rates of wages, to bitter disputes. From the influence of usage, custom, and precedent the practice

of men is to reckon in and chiefly to be swayed by nominal values. Very rarely in their day to day affairs do they stop to think out or to apply economic principles. Few besides have more than a sketchy idea of economic principles, and some prevalent ideas on economics are quite misleading.

It is worth while noting that the influence of the conditions which affect price is greatest, and is most rapidly apparent on the factor of quantity ; slower in operation on the factor of quality ; slower still on the factor of adaptableness ; yet slower on that of choiceness ; and slowest of all on the factor of rarity.

The meaning is that a surplus or deficit in mere quantity at any time or place is the most rapidly adjusted, and that **price variations due to quantity are the most temporary.** The variations due to other factors are less readily adjusted, but, where adjusted, are more abiding.

To make these conclusions intelligible let us take some simple illustrations.

We will begin at the quantity end of the scale with some common commodity like wheat. As to time and place wheat is subject to variation in quantity from difference of seasons. A poor harvest means a rise in production cost plus an increase in risk. The farmer has to do as much work and at as great an outlay in raising a poor harvest in a bad season, as in raising a full harvest in a good season. There is, therefore, a positive rise in production cost. Plus increase of risk, and conjoined with the localised fall in quantity, that sends up the price. If, however, facilities of exchange are good, and transport costs

moderate, supplies, flowing in from elsewhere, will tend to lessen the scarcity and check the price rise. If, on the contrary, facilities of exchange are either not free or not good, and transport costs heavy, the check to price will either be absent or feeble.

Economically the difference between these two states of things is that in the one instance the rise in production cost is in part offset, and in the other instance it is not. Suppose in a particular year the wheat harvest of a country fails. That means an economic loss, and the loss is reflected in the rise in price, and the rise in price means that the public have to pay more for bread. If there is no check to the rise in price, the whole of the loss falls upon consumers of bread. But if there is a check to the rise, the economic loss is reduced in proportion to the check. It is true of course that in this latter case the balance of loss will be shared between farmers and the consumers of bread, and that as there are a good many consumers to every farmer, the wheat grower's share will be individually the heavier.

Under conditions of free importation where the price rise is checked even in bad seasons, this will add to the risks of wheat growing, for while the public at large will be saved from economic loss, the farmer will be denied the compensation for decrease in quantity arising from scarcity value, and under such conditions, as has happened in England, agriculture will tend to seek less risky developments, and rely upon the importation of wheat. The aim of the Corn Laws in England was to limit the risks incidental to wheat growing in a variable climate by not allowing

wheat to be imported unless and until price, owing to scarcity, had risen to and beyond a given level. That reduced wheat growers' losses in bad years, but though the policy had that advantage, it had two very serious disadvantages. One of them was that it rendered the importation of wheat too speculative to be reliable, and failed to limit scarcity prices, and the other was that these scarcity prices were an economic injury to the country as a whole. As the full effect of the rise in production cost was felt, and felt most of all by the poorest classes, the common economic loss was not made up for because wheat growers did not share in it. The loss was there all the same. Let us suppose that in an average year the wheat harvest of a country is worth £100,000,000. If in a bad year only half the average quantity is grown, and the price goes up to double, the public in the form of the higher cost of bread suffers an economic loss of £50,000,000.

As a fact, however, the loss sustained is always much heavier. Besides the rise in wheat-growing costs and risks, distribution costs are then also increased. In distribution, while turnover will be contracted, as there will be less of the commodity to be dealt with, the services of millers, bakers, and others have to be paid for just the same, and their risk is also heightened. Hence a rise in the price of wheat owing to a bad harvest means a proportionally still higher rise in the price of flour, and another proportionally yet higher rise in the price of bread.

Agricultural products, whether foodstuffs or raw materials, are, because of variations in seasons, most of all subject to these quantity price movements.

But it has been said that price movements arising from surplus or deficit are of all others the most temporary, since adjustment in point of quantity is most readily made.

One of the effects of commerce is to render such adjustments rapid and sure. **The influence then of commerce is towards the equalising and steadying of prices.**

Under that head the opening up and intercommunication with the Southern Hemisphere of the Globe as well as the opening up of tropical countries, has, in modern times, brought about an almost revolutionary change.

The seasons of the Southern Hemisphere are, in point of time, the converse of those of the Northern Hemisphere, and in regard to excess or deficit of common foodstuff supplies in any country, the world, through commerce, in the matter of adjusting supply to demand, has been growing more and more a unit. In the old days a failure of the harvest in one country only of Europe, meant in that country scarcity or even famine, and a common failure of harvests in Europe at large would have meant the starvation of Europe. But in these days, except where means of exchange have been deliberately abolished, failure of the harvest draws in supplies, the local rise in price being quite enough to set up such a movement. On commercial movement rises and falls of price act exactly like differences of level on the flow of water. Commerce in common commodities is constantly levelling down price in one place and levelling it up in another.

Consideration of the factors that enter into price shows at once how far-fetched it is theoretically to talk of stabilising prices in the sense of rendering them always the same. While over the world at large quantity may not greatly vary in the case of any of the leading commodities, it is always varying as between place and place in the world. Quality, too, is just as variable so far as localities go, and grade affects commercial movement hardly less than quantity. Similarly with the other factors. Every one of them contributes to the life of trade. On the other hand, there are the steadying counter-influences of custom, usage, and precedent, where they are not upset by political disturbances.

The combined result of steamships, railways, mail services, and telegraphs, added to banking and the use of instruments of credit, has been the evolution in the interchange of the great commodities of what is known as a **world-price.** World prices are based upon estimated world consumption as compared with world supply from season to season. The estimates are inductions from and averages of experience. Their utility is that they enable merchants to find out reliably and swiftly where the commodity is cheap or dear accordingly as its local price is below or above the world-price level. That economically is of great importance. It limits the element of mere conjecture, and reduces risk. Evolution of world prices has brought about, in turn, the practice of **contracts for forward delivery.** Such contracts, which really represent a form of insurance against risk, have given a marked impetus to international dealings. As all

agricultural products are liable to deterioration from lapse of time, though of course some are much more perishable than others, readiness in marketing is of the first importance.

When prices are spoken of theoretically it is often forgotten that the condition of risk is a governing condition. Where risk is narrowed there is economic gain; where it is broadened there is economic loss. One of the consequences of the Great War was that the aggregate of economic loss from increase of commercial risk was very heavy. For the time world prices were upset; and owing to the fluctuations in the exchange values of currencies, most forward contracts became speculative. All this, owing to greater risk, went to inflate prices. And higher costs of transport had the same effect. The producer in one part of the world did not get more, or very little more; but the consumer in another part of the world had to pay as a rule a good deal more. It was not simply that the larger difference stood for the heavier "squeeze" of middlemen. It was owing to the fact that the gains and profits of traders were more uncertain and speculative. Risk has always to be paid for by somebody. It is not possible to indulge in political rows and ructions without reaction on economic well-being.

Adjustment of Supply to Demand in point of quantity and grade had, and more especially as regards leading commodities, brought into existence an elaborate and delicately poised machinery of movement and balance, and not merely in international trade, but in national trade.

The widened ability to discover markets, and the greater facility of marketing, throws into relief, as it were, the relationship between exchange and production. Demand in point of quantity being better known and better gauged, the play of quality becomes more marked. Differences in grade are then more definitely and distinctly reflected in price variations. Hence all the great foodstuff and raw material commodities have become accurately graded, and their comparative values assessed.

These elements of quantity and grade apply more particularly to foodstuffs and clothing stuffs. When, however, we come to such commodities as tools, implements, machinery, and manufacturing equipment and plant, the element of fitness, or adaptableness to the end in view is of particular importance. It is of leading importance, indeed, in all commodities having more or less of permanence. In clothing, value, as reflected in price, depends on finish, taste, and design not less than on quality of material. In the manufactures of metals price depends even more on adaptation, invention and design, than on material. Design, and quality are here in fact the main price element. It is the brains and skill it represents, and its use for the intended purpose that makes the value of a machine, not the iron it embodies.

Abstract in themselves, ability, invention, skill, and taste are thus through industry translated into concrete values. Those abstract things are a very large part of the wealth and welfare of the world.

As skill and adaptableness is the main price element of machinery and apparatus of every kind, so choice-

ness is the main price element of works of art of every kind. Price here depends upon how far the love of what is choice is diffused. If it be widely diffused the price will be good, and art will be encouraged; if it be but little diffused and casual, the price will be low and art will be discouraged. And if the love of the choice becomes love of the grotesque, art will be influenced accordingly.

Finally we come at the bottom of the scale to the element of rarity, which applies partly to works of art that are unique, partly to jewels, and partly to the precious metals. Rarity as a price element arises when in relation to the desire to possess, there is a permanent, natural, and irremovable limitation of supply.

The great examples of this economic rarity are the precious metals, and more particularly gold.

**Gold,** owing to its imperishableness, has a wide utility in manufacture. In modern times, however, its main usefulness has become that of a medium of exchange on account not alone of its being imperishable, and of the impossibility of imitating it, but **because it is the one commodity of exchange which presents the greatest constancy of value.**

The value in exchange even of gold is not fixed, but general changes in its value are gradual, and where they occur are so wide that, as a medium or measure of value, it is more reliable than any other.

In the first place its quantity is not liable to shrinkages and expansions. Its quantity value, indeed, is affected only by two influences; one of them the proportion of it that goes into private and secret hoards;

the other the absolute increase in the total world stock owing to mining production. The first of these influences tends to make gold dear; the second to make it cheap.

When gold is dear any given quantity of the metal as a medium will purchase more of other commodities or more in the way of services. In other words, prices and wages **in terms of gold** fall. When gold is cheap so much gold as a medium will purchase less, and **in terms of gold** prices and wages rise.

The tendency arising from the production of gold through mining is to render the metal cheaper, and therefore to raise prices and wages. But that tendency is checked to begin with by increase and improvement of production generally, and next by the extent to which gold is hoarded more especially in India and other countries in the East. During the nineteenth century the world's stock of gold, now estimated at 1,000,000,000 fine ounces, was added to by new discoveries of goldfields and by mining at a greater rate than was ever before known, but science, invention, and the improvement of production advanced also at a rate never before known. Had there been no improvement in production, prices, in view of the output of gold, would have gone up. The metal, that is to say, would have become cheaper and cheaper as its quantity increased. But the advance in production was the more rapid advance of the two, and the result was that in terms of gold prices just as steadily tended downwards. Gold, notwithstanding its larger quantity, kept on rising in exchange value.

Which is the true index of welfare—that prices

should be tending downwards, or that prices should be tending upwards ?

**The true index of welfare is that prices should be tending downwards.**

Why ? Because a downward trend of prices reflects improvement of production, and, save from accident, it never arises, and cannot, as a tendency, arise from any other cause. But improvement of production means enhancement of the value of services. For this reason a downward tendency in prices is accompanied by an upward movement in wages and incomes. On that point exact investigation leaves no doubt whatever. Nor is it really hard to see why it should be so. The real wealth of the world is then growing ; and money then goes further, but because the value of services is growing at the same time, the benefit of improved production is, as fact and experience show, divided between producer and consumer, **incomes rise though prices fall.**

This reflects a change in real values, because it reflects an addition to real wealth. **But change in the value of gold as a medium is only a change in nominal values.** For instance, suppose improvement in production were to be arrested, yet increase in the world's stock of gold were to gō on. Prices in terms of gold would rise. And the value of services in terms of gold would rise also. But as the real or economic value of services would be the same the nominally higher pay for them would buy no more, and nobody would in truth be the better off.

There has been a good deal of discussion on the Gold Standard as related to fluctuations in prices, and a

theory has been put forward by the Swedish economist, Professor Gustav Cassel, that gold is subject to great and rapid changes of value. But that theory is based on what may be called an inverted view of the facts.

If we consider the price of any great world commodity such as wheat or cotton, we see at once that, in terms of gold, the price is constantly fluctuating. At one time so much gold will buy less wheat or cotton, at another time more.

In face of these changes we may either consider the exchange values of wheat or of cotton as invariable, and that of gold as variable, or we may think of gold as the measure of value, and of the cotton or wheat as the things whose value is measured by it. Whichever view be adopted, these oppositions are, after all, only the head and the tail of the same penny. If gold, in the terms of other commodities, is cheaper, the other commodities, in terms of gold, will be dearer. When prices in general fall, the value of gold rises; when prices in general rise, the value of gold falls. Whether we think of other commodities as varying in exchange value and of gold as the constant measure; or of gold as varying and of other commodities as having a constant value, is in theory optional.

But it is not so in practice. The experience and common sense of men everywhere have readily decided the option. They reckon the exchange values of other commodities in terms of gold.

The reason for the decision is plain. While the quantity of gold does not shrink, but only expands, and that gradually, and while its quality does not

change, the supply of most other commodities is variable not only in quantity, but in quality.

In going down the scale of the elements of price, we begin with those productions which in quantity and quality are most variable, and we come finally to one that is least variable. This one has, naturally enough, been adopted as the value measure of the others.

It has been shown that if the output of gold were to go on, while improvement in production at large came to a stop, prices in terms of gold would rise. Of course the converse is equally true. If we could suppose that from now on the output of gold were to cease, yet improvement in production go on, then more and more in terms of gold the value of other commodities would fall. That in countries like China has actually taken place. Owing to the scarcity of silver, in relation to production, prices have fallen until on an average they are not more than one-tenth of those in Europe. In Europe, under the same conditions, the purchasing power of the precious metals might rise to heights not yet known.

On the other hand, the output of the precious metals has a stimulating effect on production. It is to the advantage of the world that the stock of gold as well as of silver should be increased.

The results of currency depreciation on prices is a subject of some complexity, but the broad underlying principles are not difficult to grasp.

The international values of currencies, as already stated, are their values in terms of gold. Inconvertible paper currencies, however, are based upon national

credits, and such credits of course vary, and fall with every addition to public debt. But prices are fixed nationally not alone by gold values, but by usage, custom and precedent. As the internal purchasing power of paper currencies, when inconvertible, ceases to be related to gold values, yet remains influenced by usage, custom, and precedent, there is a divorce between internal purchasing power and external exchange value. The two tend to approximate, but meanwhile the result of currency debasement is confusion and uncertainty both as regards internal prices and external prices.

It is evident that to enable gold to be employed as a medium of exchange there must, assuming its purity or fineness, be some means of translating its weight into terms of currency.

That translation, based upon Troy weight, is, as stated, the Gold Standard. Alteration in the weight of, say, the sovereign and its reduction to 100 grains of fine gold, would not abolish the Gold Standard. There would be a Gold Standard just as before, and there always must be so long as gold is used as a medium of exchange at all. The standard would be altered, but it would not be abolished, and the effect of the alteration would be that to the extent of 23.27 grains of gold in every £ the British government would defraud its creditors. Instead of paying 20*s.* in the £, it would pay 16*s.* 2*d.* in the £. And every private contract and obligation would be similarly modified.

The alleged mystery as to rates of exchange is quite imaginary. The key to the supposed puzzle is to bear in mind that currency dealings express the

estimated values, or if the word be preferred, prices, of currencies in terms of gold.

To arrive at the laws or abiding tendencies which govern prices it is necessary clearly to separate the normal from the abnormal.

The very fact that various elements enter into price, and that price is also governed by several conditions, renders the normal state of things complex enough, and that very complexity lends emphasis to the need of having as the medium of exchange and measure of values, national and international, some commodity which is itself as stable as possible.

**Broadly the use of gold as a medium of exchange goes to steady and limit fluctuations in prices whether national or international.** Economically that result is a highly important result.

When a national currency has a gold basis there is the greatest certainty of contract. Debtors and creditors both know the meaning of obligations entered into, and that contributes to common welfare by inducing common confidence, and when all currencies have a gold basis and the movement of gold is free, there is the same common confidence in international dealings. **A currency on a gold basis ensures that price fluctuations will remain within the normal limits arising from Supply and Demand.**

But when the gold basis, the assured and steady measure of values and obligations, is abandoned, we at once have a state of things that is abnormal. Certainty gives place to uncertainty; confidence to lack of confidence. The most violent ups and downs of prices always occur where "fiat" money has been

substituted for gold. If, further, the basis be abandoned or suspended by a number of governments, as has occurred since the Great War, difficulties of foreign trade react upon home trade. The prices of such commodities as a country buys abroad go up; the prices of those it sells abroad go down. And, as was the case in Great Britain during the latter part of 1920, a severe slump in commerce is the consequence.

**The difference between the international gold value of currencies, and their internal purchasing power** is a phenomenon that has appeared since the War in most European countries. Thus in Germany at the beginning of 1922, while the international or gold value of the paper mark was 1.98 pfennigs, or about one-third of ½*d*., its internal purchasing power was 5.08 pfennigs, or just over ½*d*. Also, while the international value of the Polish mark was 18,000 to the £, the internal purchasing power was, as in Germany, thrice as high. The cause of the disparity was on the one hand the low level of the national credit abroad arising from excess of public expenditure over revenue and heavy issues of new paper money, and on the other hand public subsidies for the purpose of cheapening bread, coal, railway transit, postage, etc., and the influence of custom. It takes time for a people to become used to the idea that a unit of currency, long looked upon as valuable, has little or no value. Thus were the total of British Treasury notes in circulation to be increased forty times over, the purchasing power of the £ would not at once fall to 6*d*. The influence of custom, and the old-standing prestige attaching to the name "pound" would

cause the fall—otherwise the rise in prices and wages—to be gradual, even though it might relatively be rapid. The more frugal and saving a people are, the more gradual will such a fall be. Another instance of disparity is afforded by the subsidy which for a time the Italian government paid on wheat. Purchases of foreign wheat, financed by note issues, ran down the valuta of the lira abroad, while cheapened bread kept up its purchasing power at home.

# CHAPTER XIII

## WAGES AND PROFITS

Wages not Determined Merely by the Supply of Labour in Quantity—Quality an Essential Element of All Services—True Economic Estimation of the Cost of Labour—Ratio of Cost to Result—The Quality of Labour Raised by Lowering its Cost to Result—The Cheapest Labour Earns the Highest Wages—Effect of Cheapened Production on Demand and of Demand upon Wage Rates—Benefits Balanced between Producer and Consumer—Results of Increasing the Ratio of Skilled to Unskilled Labour—The Law of Diminishing Return in Regard to Wages—Influence of Usage and Custom on Wages—Wages Raised by Improvement in Production and Fall in the Rate on Money—The Benefit of Improved Production both Direct and Indirect—A General Rise in Wages Accompanies a General Fall in Prices—Influence on Wages of Dear and Cheap Capital—The "Trustification" of Industry—The Test of Prosperity—Prices more Sensitive to Increase or Decrease of Production than Wages.

WAGES are the exchange values of services in terms of money. Profits and wages are linked together by the fact that both stand for returns for services. Instead of being, as often believed, opposed, **the economic principles which govern and determine wages and profits are identical.**

Rates of wages are not determined simply by the supply of labour in relation to the demand for it. The first of the facts concerning labour in any civilised society is that it is almost infinitely differentiated and varied. The overwhelming majority of men follow definite and distinctive callings.

Of Labour, therefore, quality is an essential element. The quality ranges from mere physical capacity with a minimum of skill and experience, through many degrees of skill and experience up to highly specialised and rare qualifications and capabilities.

While always an integral part of the value of labour, physical capacity is limited in comparison with mental capacity. Men, as already pointed out, do not differ anything like so much in bodily strength and fitness as they differ in mental capacity, education, training, knowledge, experience, sagacity, character, and talent.

For that reason another of the great social facts relating to **labour** is that it **ranges from work almost wholly physical to work almost purely mental.** Another fact is that **these two kinds of work cannot be carried on apart.** There is no conceivable scheme of production and industry, nor any conceivable scheme of exchange in which the business of direction, planning and design, and the work of accountancy and agency would not have to be done by somebody. In the construction of a bridge or a railway terminus it is the calculations and plans of the engineers which give meaning to the stroke of every hammer. In the construction of a building it is the calculations and plans of the architect. It is the same in the building of ships; the construction

of machinery; the manufacture of fabrics; the operations of agriculture; or the conduct of trade. The combination of mental labour with manual labour runs through all human effort from the painting of pictures right down to the planting of cabbages.

"Labour" as a term applied only to those grades of work in which physical effort is most evident is a pure convention. **As civilisation rises human muscular effort is less and less important in comparison with brain effort.** To the latter, alike in range and in variety, there is no assignable limit.

The definition that every effort, mental or physical, which assists to produce or to preserve value is economically Labour, covers work of every kind. To turn the potential riches of the globe into realised riches adapted to human life and well-being is at once the aim of all honest labour, and the source of its rewards.

The first then of the economic principles governing the value of services, and therefore of wages and profits alike, is that such value rises as production improves, and production is improved in proportion as the results in realised wealth are greater in ratio with the time and effort put in upon them. If men come to create twice the realised value in one half the time, they quadruple their production.

From that follows **the economic relationship between the quantity of Labour and the quality of Labour.**

The more labour is saved in quantity in ratio with results, the more is its economic value raised. On the other hand, if the quantity of labour be increased

in ratio with results, the more is its value economically lowered.

The truth of the statement just made is evident even on the face of it. Where it takes four men to produce no better result than two, the value of the services of the four can only be half the value of the services of the two.

From this there arises a consequence of the first importance. The consequence is that **the raising of the economic value of labour levels up its quality; and the lowering of its economic value levels down its quality.**

Putting the principle and its sequel together, we have the conclusion that the saving of labour in quantity in proportion to result, raises its quality, and the waste of labour in quantity lowers its quality.

This conclusion is worth while elucidating.

In the first place it is necessary to determine what makes human service economically dear or cheap. When ratio of cost to result is high, labour is dear; when ratio of cost to result is low, labour is cheap. There is a minimum of cost below which human labour, however low in quality, cannot be depressed. The human worker must at least sustain life, and health enough to do this work. That is the datum.

The existence of that datum has several economic consequences of great moment. One of these consequences has been the evolution of free contract as regards human services; another has been the search for and the discovery of mechanical substitutes for the lowest, or merely physical, grade of human labour owing to its high cost in ratio with its results. Each

of these developments represents a powerful economic tendency.

Of the consequences mentioned we may take, to begin with, the evolution of free contract.

For a very long age in Europe the idea held its ground that the cheapest labour was slave labour. Men thought that if labourers were overcome in war, captured, and owned, and paid no wages, their work was got, under constraint, on the lowest terms. And even when with the fall of the Roman Empire chattel slavery died out, the same idea still held its ground under forms of serfdom. Only very slowly was opinion on this point changed. In some parts of Europe serfdom continued to exist until the end of the eighteenth century, and in Russia it prevailed until the middle of the nineteenth century. It was only at length abolished by an imperial ukase. There are traces of the same opinion even now in the notion that low wages mean cheap labour. Economically that belief is a fallacy.

**Human labour is dear or cheap in the ratio of its cost to the value created that results from it.** It is dear when its cost to value created is high; it is cheap when its cost to value created is low. When labour actually costs more even on the datum level than the value it creates, it is not only dear; it becomes worthless and a "white elephant." The excess of initial and current cost to resultant value is the reason why slave labour does not pay, never has paid, and never can pay.

Why is that the case? Because ratio of cost to result depends on two things—the first, intelligence

and skill; the second, incentive. These two things are linked up. The more intelligence and skill there is, the stronger will be the incentive. There may be exceptions to that rule admittedly. Nevertheless it is the rule. In point of incentive the least intelligent and skilful labour is weakest. In the least intelligent and skilful labour there is least interest and most discontent.

Now servile conditions and conditions savouring of servitude destroy incentive, because they destroy interest in result, and cause discontent to become chronic and at its worst. In turn, that state of things reacts on intelligence and skill. The labourer under servile conditions, knowing that his intelligence and skill will not benefit himself, is not concerned to become intelligent and skilful. The driving motive under which he works is the motive of fear.

The first result, then, of free contract is its effect on motive. Under free contract a man enters into an engagement to render services because it is to his advantage. There has, therefore, at least to be as much incentive as will keep the engagement going.

That may seem a very feeble impetus, but apparently feeble as it is, a very widespread and marked economic change has arisen out of it, and the change is still going on.

The change has been the discovery that **the main economy of labour, and the means of reducing its cost lies in raising its level,** and in widening the field for intelligence and skill. Related to that discovery is the further realisation that this can only be done by saving human labour in quantity—in

effect, raising its value by increasing result in ratio with cost.

**Economically cheap labour does not mean low wages.** On the contrary, the cheapest labour earns the highest wages and rewards, and the dearest labour the lowest wages and rewards.

No doubt that sounds like a paradox. The paradox, however, is easily proved.

In any civilised country an entirely unskilled labourer of limited intelligence and knowledge has, though he cannot satisfy them, nearly as many wants as a skilled man. But the value created by his mere muscle work is so limited also that the lowest wage on which he can live still leaves his work dear. Even on the datum level the lowest grade of human labour remains costly. In consequence there is a constant tendency to seek substitutes for it.

That explains the second development alluded to.

Successively substitutes have been found to begin with in animal power, which is ten times as cheap, and next in steam power, which is thirty times as cheap. A yet newer, and prospectively yet cheaper, substitute is electrical energy. All these substitutes, but more especially steam power and electrical energy, have abolished an incalculable total of sheer human drudgery.

But what has been the result? Steam power and electrical energy are not only thirty times as cheap as human muscle work, but can be indefinitely and at will multiplied as human labourers cannot be. And the result has been, to start with, that the production cost of almost all commodities has been lowered beyond any precedent in history.

That lowering applies alike to foodstuffs, raw materials, and manufactures of every kind. The use of machinery in agriculture has brought down the cost of foodstuffs and raw materials; the use of machinery in transport has had the same effect; the use of machinery in manufacture has revolutionised manufacture.

But what has been the further result of this lowering of cost? The further result has been a vast expansion of demand.

The relationship of the expansion of demand to cost is that **as price falls in arithmetical ratio, demand widens in a geometrical ratio;** and, conversely, a rise in price in arithmetical ratio narrows demand in geometrical ratio.

Stating the relation broadly, if the cost of a product falls to one half, the demand will be four times as great; if the cost falls to one-fourth, the demand will be eight times as great and so on. This is confirmed by all experience, for if and when demand becomes satisfied in point of quantity, the rise in quality and the tendency to variety set in.

The expanded demand arising from lowering of cost affords correspondingly enlarged openings and opportunities for intelligence and skill in production.

Apart from the saving of human labour in quantity, and the discovery of substitutes for the most costly forms of it, nothing of this would have been possible. The abolition of human drudgery does not mean that human labour is done away with. It means that human labour is lifted on to higher levels, and translated into higher forms. And it is so lifted and trans-

lated because economically **the higher it rises the cheaper it is.**

The saving, therefore, of labour in quantity means its advancement in quality, and it can advance in quality in no other way.

Are there any instances of commodities having gone down to one-fourth in production cost, while the demand for them has expanded, as said, eight times over ?

There are many, but we may take, to begin with, one of the simplest instances—that of coal.

Coal-mining is an industry in which a relatively high proportion of unskilled labour has still to be employed, but if coal had also to be wound up to the pit bank by human muscle work, the production cost of the mineral would be so high that demand would shrink to a small fraction of what it is. The application of steam power to the winding of coal, as well as other mechanical applications, has not only made deep mining possible, where it would have remained impossible, but, by lowering cost, has made the consumption of coal general. Obviously the widening of consumption and of production has enabled so many more hewers and other skilled men to be employed. There are times over more skilled men employed under these conditions than there would have been skilled and unskilled together under primitive conditions. What is more, the skilled men can at the same time be employed at better wages. Where owing to waste of labour in quantity production is costly and demand narrowed, then, in order to foster demand, the product has to be sold at a low margin over cost. The result is that the level of wages and

of profits for all engaged in the industry is low. But with the saving of labour by the doing away of mere drudgery, expanding demand allows of the margin over cost to be widened.

Another instance that may be taken is that of the manufacture of cotton fabrics. If we go back a century and a half in Lancashire, we find the cost of such fabrics, quality for quality, more than four times what it is now. Cotton fabrics were then made by hand, and the operative, besides using his brains and his hands, had with his legs to do practically the work of a horse in driving his spinning mule or his loom. And it was very exhausting labour; a strain on both muscle and mind. It was also very poorly paid labour. Cotton fabrics being dear, the demand for them was a limited demand, and the profit on their manufacture was low. In proportion to result labour cost was high, poor wages notwithstanding.

Then, first of all, water power was introduced, and later steam-power. The mere treadmill work was shifted on to the steam-engine, and every engine in driving the machinery of a mill did the work of a battalion of labourers at a small fraction of the expense. The work of the operative became that of a skilled man and ceased to be a combination of skilled man and human donkey.

The cost of cotton fabrics went down, but as it went down demand widened out yet faster. The manufacture grew much more varied. At the same time earnings went up, not only because production was more efficient, but because it was vastly more speedy. It was not merely a question of the difference

in value between raw cotton and the finished fabric, weight for weight, but how much of that difference could be created in a given time.

Owing to geometrical expansion of demand when there is an arithmetical fall in cost, the whole of the saving in cost does not go to the consumer. Part of it appears in the lowered price, but part also appears in the higher rate of earnings, and much more in the higher aggregate of earnings. It is a great mistake to imagine that improvement in production is not worth while because all the benefit goes to the consumer. **The benefit is balanced between consumer and producer,** and even though the balance may vary, it is never all on one side.

As compared with 150 years ago a Lancashire operative now in any given time creates many times over the value. As that greater creation of value is a positive addition to wealth, so, despite the fall in the cost of cotton fabrics, the operative earns high wages and is worth them, where his predecessor earned low wages. Further, where one operative then earned a bare living, fifteen now earn a better living. The saving in the quantitative cost of labour has both raised its value and opened out this hugely widened opportunity for quality and skill.

And that, in every industry, is the effect of invention and improvement which saves human labour in mere quantity. The truth is that the value of a man as a producer lies in his brain, and that **economically he is too valuable and too costly to be used as nothing more than a physical mechanism.** As a mechanism he not only cannot compete with

the steam-engine, he cannot even compete with the donkey.

It has been said that the more human labour is by discovery and invention **translated from unskilled to skilled,** the more is it cheapened, though at the same time its rewards rise. On the test of value created to cost, the principle does not admit of dispute.

Where in any industry it is necessary to employ a high proportion of unskilled labour, the economically high cost of that labour lowers in that industry the level of real wages ; where, on the contrary, owing to the saving of unskilled labour, it becomes possible to employ a high proportion of skilled, the level of real wages is correspondingly raised, and **the highest level of real wages prevails always in industries having the highest percentage of skilled workers.** All human productive progress has arisen from the saving of unskilled labour on the one hand, and the increase of skilled labour on the other.

And this is just as true of agriculture as of manufactures. There is a larger output to labour cost as machinery and implements have become more efficient.

Notwithstanding all this, there has been constant resistance to the translation of labour from unskilled to skilled. The process has never been an easy one, and has been marked by incessant disputes. There is a widespread fear that advancement in production simply means throwing men out of their jobs. The opening up of opportunities for skill that did not exist before is either not understood or has been overlooked. Even yet a very large proportion of the human labour of the world remains low in point of

skill, and there exists a tendency from political motives rather to impede and slacken the translation than otherwise. But it ought clearly and finally to be recognised that low level of skill is economic loss, and that the opposing economic tendency to translation is constant, and as long as production is improving is bound to go on.

When it is said that the more skilled and intelligent Labour is the cheaper it is, the fact, thus broadly stated, means that in ratio with the value it creates, unskilled labour, because of datum cost, is the more highly paid. The explanation is found in the **Law of Diminishing Return.**

According to that law, a man with £1,000 a year does not derive as much satisfaction from his income as the combined satisfaction of ten men with £100 a year apiece ; nor a man with £10,000 a year so much as the combined satisfaction of ten men with £1,000 a year apiece.

This has a marked effect on rates of wages and all labour rewards.

The starting-point is the lowest wage or reward on which the lowest grade of labour can live. From the unconscious working of the Law of Diminishing Return, the tendency arising from custom and precedent is for the more valuable kinds of labour to accept less.

For instance, a skilled man whose work is intrinsically worth thrice that of an unskilled labourer, does not in general receive more than one half as much again. His product is 3, and his cost is $1\frac{1}{2}$. Therefore his labour is twice as cheap.

Again, if a highly qualified man whose work is intrinsically worth thirty times as much, accepts ten times as much, his work is thrice as cheap.

There are men whose work is worth a 1,000 times as much, but are thought well rewarded at 100 times as much. Their work is ten times as cheap.

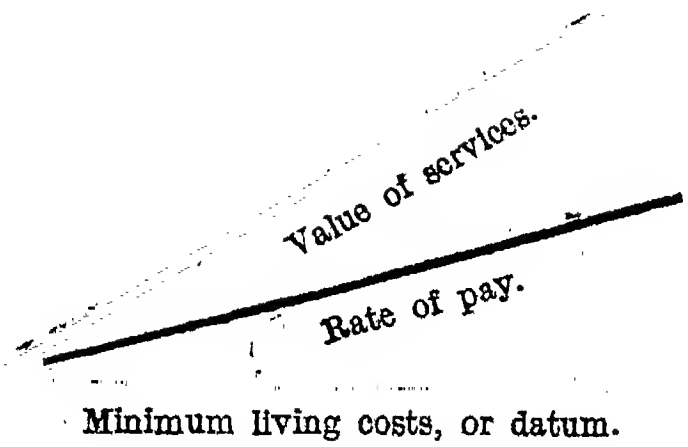
It may be denied that there can be such differences. But there are original and creative men, whose service to the world economically is positively beyond computation. They very rarely indeed receive more than the merest fraction of the benefit they bestow. The term original and creative men covers enterprising men, for enterprise is original and creative, and its bounds, economically considered, are very wide.

Two examples may be cited. The first is the instance of Joule. In thinking out the principle of the triple-expansion engine, Joule enabled every steam-engine so constructed to do the same amount of work on half the coal. He halved the fuel costs of every voyage, and reduced the fuel costs of every factory. In doing so he doubled roughly the value of the world's coal output, for twice as much could be done with it as was done before. The second instance is that of Tyndall in his discovery of the applications of electrical energy to power and light. It was the origin of vast new industries. Then there are the great chemists. There is the instance of Perkins who discovered aniline dyes made from coal. And it is not merely in the field of science and invention that this applies. It applies just as much in the field of commerce, business and finance. Great men are the world's cheapest assets. But for the labour of intelligent, original,

creative, and enterprising men of every degree, and the cheapness of that labour, the multitude would sink into starving insufficiency.

Owing to the Law of Diminishing Return the surplus value of such labour is spread over and shared by the multitude. The margin of reward over minimum living costs does not increase in ratio with the value of services. It progressively diminishes.

The working of the Law may be represented by a diagram, thus :—




On these grounds we have another economic consequence. It is that **the higher the intelligence and skill, and the more special it is, the more certain is the demand for it,** while the lower the grade of labour, the more uncertain is the demand for it, and the more casual its employment.

The economic cost of labour is not the money rate paid for it ; the economic cost is the ratio of value obtained in return for the money. The money rate paid may be low, but the value obtained low in proportion ; the money rate paid may be high, but the value obtained much more in excess of the payment.

The Wage System which obtains in Europe, and in

countries where the European type of civilisation prevails, while inevitably it has been shaped by economic influences, is also a product in its present form of custom and history. It is still in evolution, and its imperfections arise not from economic causes, but from custom and history.

The basis of it was the common rate of wages paid to agricultural labourers when serfdom gradually shaded into free service. In relation with the pay of labourers on the land, who formed the overwhelming mass of labourers, usage fixed the pay of labourers in the towns, allowing for such difference as existed between the cost of urban and rural living. And in relation to the pay of labourers in the towns, usage determined the pay for all other kinds of service according to the Law of Diminishing Return.

In mediæval Europe skilled labour early became organised into guilds, but the tendency also very soon made itself felt to turn the guilds into close corporations. Neither the economics of labour nor of commerce were understood. The industrial guilds opposed and obstructed exchange not only as between country and country, but as between town and town, and district and district. Gradually, too, they became associations which sought by monopoly to obtain the services of un-enrolled craftsmen at a low rate. For self-protection other craftsmen likewise combined, even though these combinations were declared illegal. Both employers and employed sought by regulation and by apprenticeship to restrict the number of those engaging in their industry.

Such is the origin alike of associations of employers

and of trade unions. The former on experience realised the relation between production cost and demand, but not the distinction between the real and the nominal cost of labour. The latter equally failed to see the advantage arising from translation of unskilled labour into skilled labour. The truths of economic science have only very slowly been apprehended, and mostly through trial and error. Hence the Wage System as it exists to-day presents to no small extent a conflict between economic influences and tradition and usage.

An effect of the spirit of monopoly was in past times to keep back popular education, so that when unskilled labour was saved, the translation of it into skilled labour was made by ignorance and prejudice more difficult. No monopolistic combinations, however, can stand against economic causes. The alternative to the wage system is co-operative groups, all the members sharing alike in the risks and profits of their enterprises, but that alternative is impossible so long as there is reluctance to recognise that skill and ability are cheap, and lack of skill and ability dear.

Much mischief has been done by theories asserting that the reward of labour depends upon the quantity available only, leaving the facts of quality and differentiation out of account. Such theories have led to the efforts to make labour of one kind and another scarce. **But mere scarcity of labour cannot raise wages above their economic level.** If by such means advancement of production finds itself checked in one direction, it seeks another direction.

Let us suppose that through close association the

number of hewers employed in coal-mining in any country was kept below the number needed, and that in consequence hewers demanded a rate of wages above the value of their work. The efforts to overcome the obstacle would cause the less valuable mines to be closed; or more coal-cutting machinery would be used; or owing to the higher price of coal more oil would be used, and new contrivances for burning oil brought out. In the end hewers' wages would fall to their economic level, and the only result would be injury of the coal industry.

It has often been alleged that employers of labour desire to keep in existence a **surplus of labour** over and above the employment available for it. Their aim, it is said, is by working overtime, and by speeding up, to keep the number employed chronically below the number employable. But no device on the part of employers can keep in an industry more than there is work for if the number over do not choose to remain in the industry. Employment is a matter of business, and as a matter of business employers seek to get the best result for the cost. Equally the best result for the cost is in the interests of the earners of wages. Bad methods, waste of any kind, and slacking are certain to be reflected either in curtailment of employment or in rates of pay. Somebody is bound to pay for them.

The combined effect on total earnings of improved production, economy of labour and increased demand is a very remarkable one, and may be expressed thus:

If in $x$ hours there be created £$y$ of value at £$z$

labour costs, and this, owing to improvement in production becomes, in $x$ hours £$2y$ of value at £$\frac{x}{2}$ labour costs, the ratio of product to labour costs is increased 4 to 1, and if the product is sold at half the price, it will still give twice the former return. But sale at half the former price will quadruple demand, and the final result is that in $x$ hours there will be created £$8y$ of value at £$2z$ labour costs. Consequently twice the former amount of labour will be employed. But as the return is double what it was, the labour can be paid at double the former rate. On the old footing the labour cost would have been £$8z$. It has now fallen to £$2z$, and if it is paid at the rate of £$4z$, it will yet be twice as cheap. Here the assumption is that one half the benefit arising from improved production goes to consumers in the shape of lower price, and one half to producers in the form of higher reward. Owing to expansion of demand there are now, even at the higher reward, twice as many producers, because there are four times as many consumers.

There are modern industries in which, as compared with 100 years ago, there can be created in any given time, say a working week, £$10y$ of value at £$\frac{x}{10}$ labour costs, or 100 times the old ratio. And if these products are sold at one-fourth the old price, and demand is sixteen times as large, we have in the given time, as against the production of a century ago, a value created at 1 per cent. only of the old outlay. The reduced price, however, is 25 per cent., so that there is a difference of 24 per cent. in favour of the producers as well as the difference of 75 per cent. in favour of consumers. Out of the first difference of 24 per cent.

the rewards of producers may be times over as high and yet their work will be times over as cheap; and there will be sixteen times as many of them besides.

This rise in the rewards of producers is just because it is co-related to a rise in the level of skill, and their service is the more valuable.

**Rates of wages then rise as Labour owing to improvement in production is levelled up in quality and value, and lowered in cost economically.** The influence of quantity on rates of wages is limited and temporary compared with the influence of quality.

It is supposed that science and invention not only displace labour, but degrade it and drive down wages. There has been much talk about the evil effect of machinery, and the rise of the machine has been assumed to lower the man.

The truth is the contrary. By abolishing drudgery science and invention have increased the demand for labour, and most of all for skilled labour. Indeed, all skilled labour is the outcome of science and invention.

Take the invention of the locomotive. It was said against it that it would drive out of employment all engaged in stage-coaching and stage-wagoning, and it did. But where stage-coaches and stage-wagons had given work to thousands, railways gave work to hundreds of thousands, a vast multitude of them skilled craftsmen.

The more intricate, advanced and perfect machinery becomes; the more mechanical and chemical processes are applied in production; and the more human

drudgery disappears, the more is Labour shifted from muscle to mind. Literally by these means labour is humanised. The distinctively human or thinking element grows more important, not less.

We now see why rates of wages rise when prices fall and fall when prices rise when the change in either case is the outcome of economic causes. In the one instance there is advancement in production shared between producers and consumers; in the other there is decline in production, shared between producers and consumers in precisely the same way.

It is very common to speak and think of producers and consumers as though they were different and distinct masses of people whose interests are opposed. But they are one and the same mass, for every producer is a consumer, and every consumer, not a dependent, a producer. To the producer, therefore, the advantage of improved production is both direct and indirect. His higher wages at the same time go further.

Suppose in every industry it was decided to limit production. The only result would be a fall in real wages. If nominal wages remained the same they would only buy half as much as before, or less than half as much. And if wages went up the rise in prices would always outstrip them. Decrease of production would remain the fundamental economic fact, and no shifting or contriving would alter it.

A doctrine has come recently into vogue that wages ought to correspond not with the value of services, but with costs of living. In spite of all such theorising **wages are bound to adjust themselves to the values of services.** There is no known method by

which men at large can permanently be compelled to give something for nothing.

But another influence which affects wages, and it is an important influence, is the rate on money. **A high rate of interest on money tends to lower wages, and a low rate on money to raise wages.**

That brings us to the consideration of profits.

In part profits are wages; in part return on money invested as active Capital.

Profits are in part wages when an employer of labour himself takes an active part in his business. He is but one among the workers engaged in it. The profits of people who keep shops are in like manner for the most part wages for services as distributors. Whether a man pays wages to others or pays them to himself makes no difference to the fact that all earnings must arise in the same way—from value created.

The return on money invested is also a wage since money renders service in the form of command over goods or other services. **The return on money includes both payment for its service, and payment for risk accepted.**

Both these elements affect the rate of return. If there is much money saved and seeking employment, the return upon it for its service—its "wage"—will be low, and if the risk be small at the same time, the rate on money will be at a minimum.

In that case, with abundant Capital available, enterprise will be active, and the demand for labour and the opportunities of labour good. And this will be still more the case if the risk be narrowed, as, for instance, in a time of settled peace and industrial

concord. The rate of wages will then be a rising rate.

But if money seeking employment be drained off by war, or drained off by taxation, the "wage" of the remainder will go up. And if risks be increased at the same time from these or from other causes, a still higher return will be demanded to compensate for the risk. The rate on money will then be a maximum.

As both the current "wage" and the risks of Capital have to be paid out of value created, there is so much less left for the Labour which employs the Capital, for, as already said, **Labour is the employer and Capital the employed, and not the converse.**

It is therefore to the interests of Labour of every grade that active Capital should be abundant and its risks as low as possible. And it is not to the interest of Labour of any grade that Capital should be scarce and dear, and its risks aggravated. Risks have to be paid for like everything else.

It makes, for example, a very great deal of difference whether Capital can be obtained at 3 per cent. or at 8 per cent. At the lower figure it will be far more readily obtainable, and the effect on enterprise will be reflected in work and wages. At the higher figure it will be got only with difficulty, and a good many schemes and ventures will be hung up. Wages will then be on the down grade. Besides, the difference between these two rates means £5,000 a year on £100,000 of Capital engaged, and £5,000 a year is £10 a year averaged among 500 workers, or £20 a year averaged among 250.

The facts just mentioned are at the bottom of the

**Wage Fund Theory,** a clumsy and wrong-headed attempt to explain them. There is no such thing as a Wage Fund, but there is such a thing as the dearness of Capital or the cheapness of Capital. The return on Capital is competitive.

**The test of prosperity is a rise in earnings accompanied by a fall in prices; the surest evidence of adversity a fall in earnings accompanied by a rise in prices.**

Prices are more sensitive to increases or decreases of production than wages. The rise or fall of wages is slower.

For that the reason is that the mutual influence of Supply on Demand and of Demand on Supply is more rapidly felt in the sale and purchase of commodities than in the sale and purchase of services, and that is due to the importance in the case of services of quality and differentiation.

# CHAPTER XIV

## THE DISTRIBUTION OF WEALTH

Population and Subsistence—Fallacy of the Theory of Malthus—Increase of Population Naturally Adjusts Itself to Subsistence and the Rate of Increase Varies Accordingly—The True Law of Population and Subsistence—The Pareto Line of Relative Incomes—The Tendency of Wealth is to Diffuse Itself—Improvement and Progress in Production and Freedom of Exchange Make for Equality—Real Causes of Inequality—Increasing Difference between the Rewards of Efficiency and Inefficiency—Contrasts between Thrift and Waste—Means of Production Less and Less Monopolised—True and False Equality—Wealth Weeds Out the Unfit even more than Poverty—The Political Temptation of Wealth—Social Charges and Leakages—The Principles of Taxation—Taxation Reduces Incomes and Increases Prices—Taxes on Capital—Effect on Industry and Employment—State Benefits.

IS wealth unjustly and inequitably distributed, and if so, is the economic system responsible for the injustice ?

These are problems the economist finds himself called upon to answer. Underlying the questions there is the assumption that the economic system is a contrivance not unlike an act of parliament, amenable at will.

But the facts are that the economic system is as old as civilisation; that no man invented it; and that economic laws are the same and their working the same in every part of the world, and in every age of the world.

Men in their capabilities, energies, and characters are not equal. They never were and never will be on a dead level, and it would be a very bad thing for all of them if they were. From that cause alone there is bound to arise an unequal distribution of individual wealth.

The distribution is unequal in amount as between one man and another, but is it inequitable, and are economic laws to be blamed for the lack of equity?

In the sense of adjusting reward to merit, economic laws make for equality, and for absolute equality. Given freedom of opportunity, merits under the working of economic law receive their reward, and demerits their reward likewise. **The working of economic laws simply means that men by observing them, adapt themselves best to their environment, and in doing so achieve their greatest welfare.**

In regard to adaptation to environment a problem that relates to the distribution of wealth in the mass is the association between population and subsistence.

On that subject ideas are still, after the lapse of a century and more, influenced by the **Theory of Malthus.** The theory is that as the natural growth of population is in a geometrical ratio, while subsistence increases only in an arithmetical ratio, natural increase

of population tends to overtake subsistence. Therefore, the conclusion is, natural increase of population should be artificially or deliberately restrained.

But it is by this time evident enough that the Theory of Malthus is not based upon fact.

The potentiality of increasing in a geometrical ratio is not peculiar to human life, but is common to every form of life on the globe without exception, and the geometrical ratio for most forms of life is far higher than for human life. The human ratio of potentiality is the lowest.

There is, however, no instance on record of a population outpacing subsistence. Every form of life is, in fact, limited in its increase by the subsistence available, and the effect of the potentiality of increase, combined with the limitation of subsistence, is to bring about survival of the fittest, in other words, progressively to strengthen, modify and improve through adaptation to environment. Thus have species been evolved.

But the case of human life is different from all other forms in the fact that **man by his intelligence and command over the forces of Nature can enlarge his means of subsistence.** He lives by creative labour.

If the premises of Malthus were true, his conclusion would be true. His premises, however, beg the question, for his reasoning is based on quantity merely—the number of men to be fed; the quantity of food to be eaten. Such reasoning ignores the quality factor. Leaving that factor out of account is fatal to the Malthusian argument.

Since that argument was advanced discoveries in agriculture, chemistry, and mechanics have added to human subsistence almost incalculably. These discoveries represent the quality factor.

During the nineteenth century the world's population increased at a rate never before known. Why? Because great as the increase of population was, the increase in subsistence outstripped it.

In the course of those 100 years the population of Europe doubled; while that of the United Kingdom rose from 11 to 44 millions. The population of North America rose at the same time from 3 to 90 millions; and the population of South America from less than 2 to 30 millions.

Notwithstanding those increases, and others, the average of production was twice as high in 1900 as in 1800, the average of earnings twice as high; and the average of prices one half.

Since the beginning of the twentieth century a setback has occurred. It has not, however, been due to economic causes; it has been due to political causes. What then is the truth about population and subsistence?

The truth is that the **natural increase or decrease of population adjusts itself to subsistence, and varies as subsistence expands or narrows.**

It is not a question merely of birth-rate, but of the average age of marriage and of average death-rate. The average age of marriage is the most important factor in determining the size of families; the death-rate the important factor in determining the average length of life.

The effort of every people is to maintain their standard of living if means of subsistence be falling; and to improve it if means of subsistence are rising. Maintenance of the achieved standard of life is the impelling motive behind human custom and usage, whether savage or civilised. Both the average age of marriage and the average length of life are intimately affected by penury or welfare. With arrest in the expansion of subsistence the growth of population is checked, and **population never goes on growing long after the standard of life has been found to be falling.** Under such conditions, in the effort to keep up the standard of life, population declines. And population may also decline in an effort to raise the standard of life faster than the expansion of subsistence, or where subsistence has ceased to expand. The decline is brought about mainly by a rise in the average age of marriage, which rise in average means that there is a larger proportion of persons who do not marry. The tendency or law may be summarised thus :—

| | | | | | | |
|---|---|---|---|---|---|---|
| The | average age of marriage | falls | with increase | rises | with decrease |
| | birth-rate | rises | in the means | falls | in the means |
| | death-rate | falls | of subsistence | rises | of subsistence. |

It is of course the combination of average age of marriage with birth-rate and death-rate that gives natural increase or decrease. Obviously the birth rate falls if the percentage of childless and unmarried persons goes up.

This **adjustment of population to subsistence is constant.** Where means of subsistence are sud-

denly narrowed by breakdown of production or exchange, adjustment takes the catastrophic form of famine and plague.

We come next to the relative distribution of wealth and the differences between individual fortunes.

The Italian economist Pareto has shown that the relative distribution of wealth does not materially differ in any civilised society, and to demonstrate it in terms of quantity invented what is called the **Pareto line.** If a figure be taken as representing the average income of the most numerous class of persons, then those having an income ten times as large will be found approximately to be one-tenth as numerous; those having an income a hundred times as large will be one in a hundred; and those having an income a thousand times as large, one in a thousand.

And **the number of higher incomes in each class is always found to be relative to the number in the lowest.** If the average income level of the largest class at the bottom of the scale is raised, the number of incomes in each of the other classes is increased proportionally; if the average income level of the largest and lowest class goes down, the number of incomes in each of the other classes is decreased proportionally.

**The basis then that determines the distribution of wealth is the average of the lowest mass income.**

Suppose the average of the lowest mass income to be £50, or $250 a year. If the average be raised to £100, or $500 a year, the number in each class of higher income will be doubled.

That is the statistical aspect of the matter, but we have to get at the causes.

Over and over again it has been asserted that the tendency with increasing wealth is to make the rich richer and the poor poorer. But again no proof has been forthcoming to support the assertion.

There is a sufficient reason why not. The truth is that **the tendency of wealth is to diffuse.** It distributes itself as surely as light and warmth, and economically on a principle of perfect equality.

It is not science, invention, thrift and investment which cause inequality. On the contrary, all those things are levellers. The **causes of inequality** are individual differences of efficiency and inefficiency; knowledge and ignorance; industry and laziness; health and disease; virtue and vice; foresight and lack of foresight; character and want of character. A man is paid by society according to his services to society. The accidental fortunes are few.

Let us turn to facts. Investors are now counted by millions where a century ago they were counted by thousands; the persons following special and skilled employments and callings are tens of thousands where they were hundreds; thanks to science and invention, efficiency, knowledge, health, vigour, and character meet with greater rewards and were never so sure of the rewards; and owing to the same causes inefficiency, ignorance, disease, lack of vigour, and want of character were never so sure of being "left" and turned down. Science, invention and the diffusion of wealth speed up the elimination of these elements. It is idle to look at the larger number of millionaires

and persons with more than mass average incomes, and ignore their relation to the rise in mass incomes. The Law of Diminishing Return and the economy of highly specialised and exceptional services—the cheapness of ability in ratio with its pay—inevitably goes to produce rich men, but they are a **minimum** not a maximum.

There is a reason for the elimination of the elements which Mr. H. G. Wells calls the deliquescent. Wealth is a far more severe and searching social and individual test than poverty. Nothing destroys so certainly or so surely as money in weak and unworthy hands. There are more outstanding social contrasts because it is out of the question to heighten the lights without deepening the shadows. **The great aggregate of wealth to-day is emphatically mass wealth,** and not in one country only but in every country.

The contrast lies most of all between thrift and waste. If a man saves £1,000 a year and invests it at 5 per cent., at the end of twenty years he will have £34,700 or £14,700 more than his actual savings owing to the earnings of his money. If a man, on the other hand, lives beyond his income to the extent of £1,000 a year, then every year he not only makes a proportionally larger inroad into his capital, but more and more cuts down the return upon the balance. Suppose he has a fortune of £20,000. In the first year his dip into it is one-twentieth, but at the end of the tenth year his dip is one-tenth and he will have lost half the former return upon his money besides. And if he goes on at the same rate, he will come to the end of his fortune in fourteen years.

Few statements are so contrary to fact as the contention that the means of production are more and more monopolised by a narrow class to the enslavement of the many. There never was a time when, through joint-stock investment, ownership of means of production was so widely distributed. The overwhelming majority of investors are small investors. **The means of production are less and less monopolised,** and were thrift and the practice of thrift general, would speedily cease to be monopolised in any sense of the word.

That is the real cure for inequality of wealth.

The defects of the economic system being the defects of men themselves, if they choose to disfigure it with violence, passion, fraud, and denials of just dealing, they must pay the price.

What is equality ? Is it a redistribution of fortunes in equal amounts ? That, in view of the differences in men and the differences in their value, would be the most glaring inequality. It would destroy effort and incentive on the one hand and put a premium on every sort of social disability on the other, and it could only result, and that speedily, in catastrophe.

Economically it is not possible by such means to level up ; **it is only possible by defying economic laws to level down.**

A much cried up specific is the **nationalisation** of production, exchange and distribution. There is no economic salvation in such a creed, and there is not any, because exactly the same work as is now done by employers of labour and their staffs, would be done by public officials. And there would not be fewer public

officials for the purpose; there would be far more. They would cost more also, and as they would do the work by routine, the results would be vastly less. Between the lessened results and the greater cost, the share left over for manual workers would be a mere fraction of what it is. Quite the commonest device of quacks is to represent their nostrums as "reforms." The one test of a reform economically is that it puts better food on the people's tables and more of it; better clothing on their backs; better boots on their feet, and enables them to live in better houses. How many so-called reforms have fulfilled that test?

Were thrift, foresight, self-control, and habits of industry universal, it is possible to imagine so great an increase of money seeking work as active Capital that the "wage" of active Capital would fall to ½ per cent. per annum.

But that fall would become slower and slower as the rate went down, because while the low rate on money would stimulate enterprise and production, the low rate would at the same time stimulate consumption, and consumption would take on new and more varied forms. That would bring about the diffusion of objects of taste and convenience among the mass even more than the heightening of luxury among the few. If a high rate is paid on money, it is because the world is in need.

Under the working of economic laws causes and consequences tend to balance and nothing remains at extremes.

The wealthy unfit or their descendants are always being "reduced to the ranks." There cannot in any

country be a permanently large idle class, even though the country be rich. Idleness leads to degeneracy; degeneracy to waste; waste to poverty.

The causes of poverty are the same in every class of society; so are the causes of prosperity. The economic antidote to poverty is that it inspires men to effort if there is anything in them at all. Necessity is proverbially the mother of invention. The temptation of wealth is that it leads men to forego effort. No man will take care of a rich man's fortune if he does not choose to take care of it himself.

It is often objected that increase of wealth fosters luxury, and it is a very excellent excuse when the aim is to lay hands on wealth. But the term "luxury" is entirely relative. The luxury of one age is the necessity of another. In like manner the luxuries of one class of society become the necessities of another. Luxury, economically speaking, is expenditure incurred from motives of mere vanity, or on objects having neither utility nor taste. But in that sense there is as much luxury among the poor as among the rich.

Wealth is a great political temptation, and in modern times has had the effect of stimulating wars by offering an easy means of waging them. It has also fostered the belief that the economic distribution of wealth can and ought to be corrected by taxation and State benefits and reliefs. The besetting danger of popular government is inclination to unjust dealing. On that rock democracy went down in ancient Greece, and freedom in ancient Rome.

War as a road to national riches is a delusion. Even successful war never benefits more than a limited class

of political adventurers. The mass of any nation is always impoverished by it.

**And taxation imposed to "correct" the distribution of wealth** is equally delusive. Its only effect is to waste wealth and check its creation. Poor Laws and State relief, while they impoverish the rich, even more markedly distress the poor.

The reason for that is that in every civilised country the wealth of every individual rests upon rights. Let the rights be attacked, or abrogated, and the value of property of every kind tumbles down at once to rubbish levels.

Unless public and State relief be very strictly guarded, the need it seeks to relieve will grow with what it feeds upon. Two of the causes of prosperity in the United States have been the abolition of chattel slavery and the absence of Poor Law relief. When men have to sink or swim, they swim. When they are assisted to swim, they sink.

Every civilised country has certain great charges or leakages which reduce the benefits of its earnings. There are the charges of defence against foreign attack, or disorder at home; there is the social cost of rascality and swindling; there is the social cost of disease, physical and mental; there is the social cost of ignorance, prejudice, and folly. These leakages and charges in the aggregate are vast, and **not one of them has anything to do with the economic system.** So far as the charge of defence contributes to the common security, it is an essential service, and its economic results in security may be worth the outlay. But the other costs and charges are pure waste.

A government given over to practices of public dishonesty aggravates private dishonesty, and enlarges that source of economic loss. A government which relies for power on popular ignorance both arrests the creation of wealth and cherishes a great peril. Ignorance begets a brood of passions and sinks a people into low and brutal pleasures.

Legislation, to be beneficial, ought to be concerned with (1) public security, (2) the promotion of material welfare, (3) ethical advancement. The sagacious law-giver is he who understands and relies upon natural laws and causes. Society is an organic growth and not something to be hacked about by ill-conceived and merely vote-mongering acts of parliament and acts of congress.

It is not the proper business of a government to splay itself over all the activities of a people's life. Nationalisation of industries does not get rid of capitalism. It simply sets up State capitalism, and State capitalism has all the vices of the private variety without any of the virtues. State service is not equal in efficiency and economy to a correspondingly organised and privately managed enterprise.

Taxation ought, in its aims, to be kept within the limits of other legislation. When it goes beyond those limits it becomes oppressive and wasteful.

The principles of sound taxation laid down by Adam Smith are (1) that the tax should be certain in its amount, (2) that it should be equal and just in its incidence, (3) that it should be economical to collect, (4) that it should be reliable in its yield.

Few modern taxes fulfil these conditions. Oppres-

sive taxation is among the greatest economic evils of the modern world.

Taxes on land are in effect taxes on food and raw materials ; taxes on transport imposts on commodities ; taxes on income, imposts on production, exchange and distribution. **All taxes have the double effect of reducing incomes and increasing prices.**

The mischief incident to indirect taxes is that they compel dealers in a taxed commodity to advance the amount of the tax pending sale to the public, and therefore to employ a large additional capital for that purpose. Return upon that capital is added to the tax in the price of the article. For that reason there is always a considerable difference between the Treasury receipts from an indirect tax and the sum extracted from the public.

Taxes on transport have the vice that, over and above the amount of the tax, they cause losses through delay. Those losses go on to price and the weight of the tax is thus aggravated. Taxes on exchange and "turnover" taxes are unreliable in yield.

Taxes on income have the widest economic incidence and are the most economical to collect, and if assessments are certain and fair, and incidence equitable, they are the best of all forms of imposts. The incidence is equitable when the tax is proportioned to income, that is, represents an equal rate in the £ on all incomes, though relief at the lower and some graduation at the higher end of the scale is justified by the Law of Diminishing Return. If, however, income tax is so scaled up that in the higher schedules it becomes oppressive, the wealthier citizens are in effect annually

fined for being wealthy. It is a vast mistake to imagine that such fines fall exclusively on those who pay them.

In the United States nine-tenths of the whole national income pays one-tenth of the direct taxes; and one-tenth of the national income pays nine-tenths. The ratio between the lowest schedule of the tax and the highest is 1 to 80.

If a heavily-taxed income be derived from returns upon active capital, then so long as the tax continues, so much of the Capital as provides the return is for all practical purposes forfeited by the government, and the nominal owner becomes merely an agent for collecting the return and handing it over. But as he remains in control of the capital, he may, if he chooses, export it, and employ it to finance enterprises abroad, together with the return upon it. A great diminution of dynamic and active capital may arise in a country from that cause, and a shrinkage of employment.

The really sound distinction in rates of income tax is that based upon **relative certainty or uncertainty of earnings.** The personal earnings of a business or professional man are less certain than those of capital invested in debentures, mortgages or State bonds. Taxation which discourages or penalises the acceptance of business risks is a fine upon enterprise.

In addition to heavy gradations of income tax, heavy imposts have been placed upon inheritances. These are only a deferred income tax, but while income tax represents, when onerous, an inroad on active liquid capital, taxes on inheritances are an inroad on active invested capital.

All taxes on Capital have the same effect nationally as a man living in excess of his income and dipping into his capital to cover his outlays. Each year the dip becomes deeper, and each year the national income from the balance is cut down. Such taxes undermine the ability to bear them. For that reason they are the most wasteful of all taxes. The mischief is cumulative and progressive. Since they at one and the same time send up the rate on money, and restrict employment, they tend to lower all earnings and wages.

It is partly through the higher rate on money, partly through effects on rates of wages and on prices that excessive income and capital taxes are spread over the whole community. The poorest classes are in the end always the hardest hit. **Excessive and unjust taxation creates the very distress it purports to relieve.**

Whatever the excuse advanced for it, an excessive public expenditure is never a benefit and always an evil. Excessive public expenditure not only gives rise to waste, but to vested interests in waste, and to corrupt administration. No wasteful and costly government was ever yet a good one. Wasteful schemes of public expenditure are often set on foot for the sake of secret commission.

State benefits, alike in the cost of administration and in the incidental mischiefs of taxation they set up, cause more evil than they cure.

Wasteful and unsound taxation is the rock ahead of modern democracy.

The economic system is the outcome of simple yet efficient natural causes, and so long as those causes

operate there can never be any other. The causes will always operate.

Through economic causes, the Wage System, with its only partially-developed incentives, will in due time give place to free co-operation. But many prejudices have first to die.